

## C Competition

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



It is not OSFI's role to facilitate competition. However, OSFI tries to respond in a flexible manner to new initiatives put forward by the industry or policy makers. In addition, OSFI recognizes that given that solvency regulation and supervision can impose constraints on the ability of a financial institution to compete, particularly with unregulated institutions, it has an obligation to limit regulatory constraints to those that are essential for accomplishing the other elements of its mandate.

This objective is consistent with the development of a more targeted and effective regulatory and supervisory framework.

### 1997-98 Accomplishments and Initiatives

#### Preparing for foreign bank branching

In February 1997, the federal government announced that it would review its current policy on the entry and operation of foreign banks in Canada. It said it would develop a new framework for entry, including the development of a regime to permit foreign banks to operate in Canada via branches. Since 1980, foreign banks have

been restricted to banking in Canada through subsidiary operations. In revising the foreign bank entry policy, a number of factors were taken into consideration. One was a desire to increase competition in the Canadian financial marketplace while at the same time ensuring that issues such as safety, soundness and integrity of the financial system continue to be respected.



(L. to R): Michael Hale, Monique Fletcher, Richard Gresser, Lyse Lacourse

In May 1998, the government announced that the legislation amending the foreign bank entry regime would be deferred until the delivery of the report of the Task Force on the Future of the Canadian Financial Sector this fall. Notwithstanding this deferral, OSFI continues to dedicate resources to develop a supervisory framework that will accommodate direct branching by foreign banks in Canada. To this end, a Foreign Bank Branch Supervision Division has been established as part of OSFI's reorganization. This unit has been involved in developing the entry criteria, defining the assessment process and establishing the supervisory framework for bank branches. Once the enabling legislation is passed, the division will participate in the assessment of applications and be responsible for the supervision of the branches of foreign banks.

#### Facilitating the demutualization process

In the last year, four large Canadian life insurance companies announced plans to convert from mutual companies into publicly traded stock companies — a process referred to as "demutualization."

Policyholders of mutual life insurance companies own the company. In converting to a stock company, eligible policyholders would become shareholders and the company would have greater access to capital markets. Policyholders would retain the contractual benefits of their existing policies and would have the choice of either holding their new shares or selling them on the open market.

Access to capital is a key factor for Canadian insurance companies competing in both domestic and foreign markets. OSFI appreciates the increasing need for access to capital markets in a highly competitive financial services industry and is working with the Department of Finance to develop regulations to guide demutualization.

OSFI wants to ensure that the well-being of policyholders is paramount in any demutualization process. In this regard, a number of key principles will guide the development of regulations. These include the placing of a fair value on the company and the allocation of that value to policyholders, the provision of an opinion by an independent expert on the fairness and equity of the value of the company and on the method and assumptions used to calculate that value, and an opinion by an independent actuary on the fairness and equity of the nature, amount and benefits to be provided to policyholders.

#### Creating a level playing field

During 1997, OSFI, the Canadian Bankers Association, and representatives of the deposit-taking industry established a task force to identify differences in the requirements of supervisors in Canada, the United States and the United

Kingdom and determine whether changes are needed to the regulatory regime in Canada. The issues identified include general allowances, asset securitization, cumulative and non-cumulative perpetual preferred shares and other hybrid capital instruments, the assets-to-capital multiple and capital taxes. Priority was given to general allowances and asset securitization, since the Basle Committee is actively reconsidering the definition of capital for deposit-taking institutions.

**General allowances** - Under the 1988 Basle Capital Accord, general allowances of up to 1.25 per cent of risk-weighted assets can be included in tier 2 capital provided that certain criteria are met. In 1997, to foster a level playing field, OSFI decided to permit partial recognition of general allowances - up to 0.625 per cent of risk-weighted assets - in capital, with OSFI approval. Deposit-taking institutions wishing to include general provisions in capital are required to submit a written application to OSFI with an action plan outlining how they intend to recognize inherent credit risk.

**Asset securitization** - In 1998 a consultative group was formed by OSFI and the Canadian Institute of Chartered Accountants (CICA) to develop a CICA guideline for asset securitization that would be consistent with accounting treatment in the U.S. The current Canada-U.S. differences mainly centre on how to recognize a sale. Under Canadian generally accepted accounting principles (GAAP), a sale is recognized when the significant risks and rewards of the group of assets are transferred. Under U.S. GAAP, a sale is recognized when control is transferred based on individual components. Guidance from the consultative group is expected in 1999.

### Reducing overlap and duplication of regulation in the Canadian financial system

One important way to ensure that financial regulation and supervision is cost-effective and does not unduly impede competition is to look for ways to reduce overlap and duplication among jurisdictions. OSFI already performs examinations on a contract basis for certain provinces and is willing to expand that role. In the past year, OSFI started to explore the possibility of expanding that activity to include pension plan examinations for some provinces.

Last year we reported that OSFI had reached an agreement with the Financial Services Commission of Ontario (FSCO) whereby OSFI would supply FSCO with annual return data for regulated insurance companies and fraternal benefit societies operating in Ontario. As a result, these companies and societies were no longer required to file annual returns with FSCO. Since then, similar agreements have been signed with Prince Edward Island and Alberta. Some other provinces have expressed interest in this type of arrangement, and

some would prefer direct access to OSFI's databases. We will consider this alternative if there is sufficient interest.

OSFI was actively engaged during the past year in discussions with Ontario officials on the possibility of OSFI taking over the supervision of trust and loan companies incorporated in Ontario. There are some limits on what OSFI can do in terms of expertise and jurisdiction. Considerable thought has been put into how this process would work and how to handle the few areas that OSFI could not undertake. These issues will need to be resolved in order for this initiative to move forward.

### Performance Measures

One of our most significant challenges in measuring performance is to assess the degree to which our activities affect competition in the industries we regulate. Developing an appropriate measure is complex because of the number of interrelated variables involved. For example, some may view regulation only as a burden, while others see it contributing to public confidence and thereby providing value to regulated institutions.

OSFI is conducting its own studies and investigating what research is available. In developing appropriate measures, we may use information obtained in surveys conducted to assess our performance against other strategic objectives, for example, from the Effectiveness Survey that was conducted primarily to assess public confidence. OSFI is also inquiring into what equivalent measures are available in other jurisdictions. More details on this project will be reported in the 1998-99 Annual Report.



(L to R): Elvia Lam, Carl Hiralal,  
Joan Brazeau, John Sturkenboom

## C Cost-Effectiveness

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



OSFI recovers its expenses for the supervision of financial institutions through an annual 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 1997-98 are provided in Annex 1.

### 1997-98 Accomplishments and Initiatives

#### Developing an equitable cost allocation system

In response to concerns raised by industry associations and the Superintendent's goal of a more equitable allocation of costs, OSFI established an internal task force in 1996 to examine the feasibility of a modified user pay system. Based on its recommendations, OSFI proposed a number of changes in how it recovers costs from federally-regulated institutions, so that institutions and non-regulated third parties that place greater demands on OSFI would pay a higher proportion of OSFI's costs. This would be done through the use of direct user fees. The proposed user fees are based on the time spent on selected activities with due regard, where possible, to the fees charged by other regulatory agencies for similar services. This approach will modify OSFI's current practice of recovering costs from institutions and private pension plans solely on formula-based annual assessments.

OSFI believes that the implementation of user pay fees is an important step in moving towards its objective of a more cost-effective regulatory system. During an extensive consultative process, industry associations and individual institutions supported the concept of a user pay system, provided it were done in a cost-effective manner.

The views of the associations, along with those of other stakeholders, were integral in shaping OSFI's proposed phased-in implementation of user-pay fees and changes to the current assessment methodology. The first phase is scheduled for implementation on January 1, 1999.

#### Refining the budgeting process

In 1997-98, OSFI reviewed the way in which it develops, reviews, challenges and approves annual budgets. Implementation of a new business model and methodology was delayed because of the reorganization. It is expected that the new processes will be implemented in 1999-2000 planning cycle.

### Performance Measures

OSFI is considering the following as indicators of its cost-effectiveness:

- the ratio of direct and indirect supervisory costs — in dollars and staff time — to assets and/or revenues for each industry sector,
- a comparison of costs to other jurisdictions, and
- a comparison of the compliance costs by industry sector (this measure will be developed in conjunction with the development of measures for assessing OSFI's impact on competition).

The development of these measures will be completed in concert with discussions with the industry. These discussions will deal with changes to the allocation of OSFI costs across sectors and the implementation of a modified user pay scheme. More details will be available in the 1998-99 Annual Report.



(L to R): Paul Skosowski, Premachandran Subramaniam, Sheryl Slater, Christine Ring, Raneel Dhillon, Martha DeSouza



## Quality

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 is particularly difficult in the face of today's heavy demand for talented individuals by financial institutions, pay constraints in the public sector, and consequent high staff departure levels.

To respond to this challenge, OSFI is developing and implementing a multi-faceted human resources management strategy. This strategy seeks to maximize OSFI's human resource management flexibility and autonomy, to simplify and consolidate its staff relations and position classification frameworks, and to acquire and implement effective recruitment, training and professional development approaches and tools. OSFI has also taken steps to improve communication between management and staff to ensure that important issues are identified and discussed in an open and progressive manner.

### 1997-98 Accomplishments and Initiatives

#### Becoming an employer of choice

In working towards developing a dynamic and integrated management model for human resources, OSFI has looked at the best practices of the industries it regulates. During the past fiscal year, OSFI undertook two initiatives to better align human resource management and operational needs.

OSFI used the Hay Plan to assess the relative contribution of each job to the overall objectives of OSFI. As part of this initiative, a new compensation policy was developed that recognized the following:

- salaries must be competitive in order to alleviate difficulties in recruiting individuals to fill key positions and retaining the quality people needed to fulfil our mandate. Over the past few years, many experienced, high-potential employees have been recruited by the industry with the offer of better salaries and career prospects.
- salaries must recognize and reward individual performance and offer the appropriate pay incentives.
- the new compensation policy must provide for internal equity by compensating one job fairly in relation to another.

To deal with these issues, salaries were adjusted, based on an independent survey, to reflect average market rates relative to the financial sector and a number of organizations

in both the public and private sectors. In addition, performance pay will eventually be introduced for all levels.

To further increase OSFI's flexibility in recruiting and retaining talented professionals, a new delegation and service agreement was negotiated with the Public Service Commission. This agreement gives OSFI increased authority for managing human resources. Now OSFI can develop policies and procedures with respect to staffing, job assignments and career paths that are specifically suited to OSFI's specialized environment.

#### Growing our own talent

In addition to our internal and external recruitment efforts, OSFI launched a Career Management Program in 1997. This program is intended to develop a corps of professionals, who by their education, experience and learning will ensure that OSFI can fulfil its mandate in the face of rapid change in the financial services industry. Candidates are recruited both internally and on university campuses. Over a three-year period, they are exposed to many aspects of the regulatory framework, as well as functional and support activities. The program provides an opportunity to develop and apply analytical, team management, managerial, and leadership skills in a structured and progressive fashion.

#### Promoting continuous learning

OSFI continued to promote a continuous learning environment by offering a variety of specialized training



(L to R): Paul Fedser, Mala Nag, Rob Mitchell, Gayle Gee, Monica Burrows

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

programs and by ensuring that all staff have the opportunity to upgrade their knowledge and skills. By setting aside funds equal to 3 per cent of its payroll, OSFI demonstrated its commitment to professional development and training. In 1998-99 we hope to ensure each employee has an average five working days of training.

OSFI expanded its technical training programs to cover a wide spectrum of subjects including asset management, risk analysis, corporate governance and capital markets. OSFI also established self-paced learning centres at its Ottawa and Toronto locations. The centres provide employees with access to current audio-visual and multimedia learning tools dealing with technical training, communication, management, teamwork and office automation.

#### Fostering dialogue for a better workplace

As part of OSFI's commitment to continuous improvement, a comprehensive employee opinion survey was conducted in 1997. The project was undertaken to assess the level of employee satisfaction and to establish benchmarks for future assessments. As a follow-up to the survey, an Employee Advisory Group was created to make recommendations to management on communications, human resource

management, and management style and leadership. Another employee opinion survey, allowing us to assess whether improvements have been made, is planned for next year.

#### Improving internal communications

OSFI has increased its use of Internet-related technologies to meet its information processing and reporting needs and to improve communications. Last year we reported that OSFI had revamped and enhanced its Internet site. In January, we launched OSFINET, an internal corporate network (Intranet) accessible only to OSFI employees. OSFINET allows staff to access OSFI guidelines, discussion papers, databases, and personnel and financial bulletins as well as media clippings. It acts as a means of communication between staff, permitting staff to form electronically-assisted workgroups through the use of discussion groups. We expect OSFINET to reduce the need for paper-based communication.

#### Performance Measures

OSFI has identified four methods for evaluating its effectiveness in providing a high quality service. Two are directed internally at staff satisfaction and achievement of core competencies, while the other two focus on the quality of internally and externally driven services.

**Employee satisfaction** - key to OSFI's ability to fulfil its mandate is its ability to attract and retain a skilled and motivated workforce. An employee opinion survey was conducted in the summer of 1997 to assess the level of employee satisfaction.

Overall responses indicate that employees understand our mission, believe that corporate objectives are being met, and are optimistic that the changes will benefit the organization. A strong majority say they are proud to work for OSFI and find their work interesting and challenging.

However, several weaknesses were noted. In particular, 41 per cent of respondents indicated dissatisfaction with the overall effectiveness of communications at OSFI and 51 per cent feel that they could not voice their opinions freely to management. As previously mentioned, an Employee Advisory Group was created in the fall of 1997 to work with the executive to address these important issues.



(L to R): Anne Gutowski, Wayne Steele, Elaine Ren, JoAnne Bagnall, Robert Liu

Per cent of staff meeting core competencies - this measure would assist management in making decisions about recruitment, training and development, and employee assessment. It will be reported along with a brief discussion of competency gaps and actions to address deficiencies. The measure will show improvements or deterioration over time and progress against key goals.

In implementing this performance measure, OSFI will first focus on the competency profile for examiners. It is expected that data on core competency levels for all OSFI staff will be collected over the next two fiscal years.

**External quality service index** - this measure is a self-assessment of the quality of OSFI's responses to external requests for information, rulings or approvals. It will likely use a process similar to that described for the Intervention Effectiveness Measure (see Safeguarding from undue loss). The planned Quality Assurance Division will develop this measure over the next two fiscal years.

**Internal quality service index** - this measure will be used by the Corporate Services Sector and other service divisions (e.g., Legal Services and Communications) to assess its effectiveness in delivering internal services. It will be first tested in the Information Technology Division. The project will be based on service agreements with client groups that define expectations for service delivery, roles and responsibilities. Key to these agreements will be performance standards in line with industry best practices. The results will identify areas of improvement. It is expected these agreements and related standards will be in place in the 1998-99 fiscal year.

Once the success of the pilot project has been assessed, similar approaches will be implemented for other internal services such as finance, human resources, library services, and administration.



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