Competition

WE FULFIL OUR REGULATORY MANDATE HAVING DUE REGARD FOR THE NEED TO ALLOW INSTITUTIONS TO COMPETE EFFECTIVELY.

While the objective of "having due regard for the need to allow institutions to compete" may seem like a passive one (i.e., to avoid interfering with competition), OSFI moved forward proactively in 1998-99 with a number of initiatives intended to foster increased competition in the Canadian financial marketplace. These included demutualization, foreign bank branching, and accounting rules for business combinations.

ACCOMPLISHMENTS AND INITIATIVES

DEMUTUALIZATION

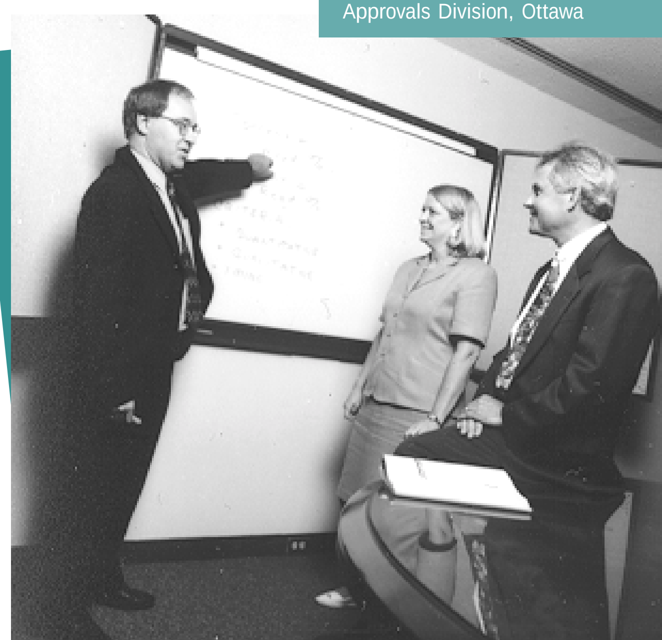
In March 1999 the government passed legislation and made regulations allowing Canada's large mutual insurance companies to convert into companies with publicly traded common stock – a process called "demutualization." In converting to a stock company, eligible policyholders become shareholders and the company gains greater access to capital markets. As of early September 1999, one company had completed this process, another was close, and two others had made significant progress.

The legislative regime allowing demutualization includes several measures to protect the interests of policyholders. For example, OSFI is required to approve material that is sent to policyholders to help them form a reasoned judgement on demutualization. OSFI has worked with the companies to ensure that policyholder information was prepared in a plain language format. OSFI also required the companies to include expert opinions on the value of the company and whether the method of allocating that value to policyholders was fair and equitable. To help OSFI evaluate the reports and opinions provided by the companies, their investment bankers, and the independent actuaries, the Office engaged its own actuarial and financial advisors.

As well, OSFI's supervisory staff have reviewed the progress made by the companies in launching their investor relations operations, in anticipation of the companies completing their proposed demutualizations.

OSFI also established a 1–800 number to assist in responding to policyholder questions on demutualization. In addition, OSFI indicated that it would make public any instances where the Superintendent provided demutualizing companies with exemptions from the regulations. At the time of writing, only one exemption had been granted, allowing a company to use, in its policyholder information documents, financial statements

George Harris, Monica Burrows and Paul Fecser of the Registration and Approvals Division, Ottawa



Kim Norris, Chuck Saab and Karen Badgerow-Croteau of Foreign Bank Branch Supervision, Ottawa

that at the date of mailing to policyholders, were more than 120 days beyond their effective date. OSFI issued a guidance note explaining the circumstances under which similar exemptions would be considered.

FOREIGN BANK BRANCHING

Throughout 1998–99, OSFI collaborated with the Department of Finance in developing legislative amendments that would permit foreign banks to operate in Canada on a branch basis. Until now, foreign banks have had to incorporate a foreign bank subsidiary (a Schedule II bank) or establish a representative office in order to carry out activities in Canada.

The Government originally announced its decision to permit foreign bank branching in February 1997. Because the MacKay Task Force planned to complete hearings and report its findings in September 1998, the Government decided to defer introducing branching amendments until the Task Force had commented on this issue. The MacKay Report endorsed foreign bank branching. After consultation with industry officials, legislation including branching amendments (Bill C–67) was tabled in February 1999 and came into force in June 1999.

Before the legislation was introduced, OSFI created a Foreign Bank Branch Supervision Division to help develop a regulatory and supervisory framework for the branching regime. As part of this process, OSFI's guidelines and regulations were reviewed to determine their appropriateness for bank branches and to make changes where necessary. To support the application process, OSFI released a *Guide to Foreign Bank Branching*. It sets out OSFI's approval criteria, application process and information requirements. One of the key elements of both the entry assessment and ongoing supervision of the branch is a thorough understanding of the supervisory system in the applicant's home country.

The development work in respect of foreign bank branching has involved considerable consultation with other government agencies and the industry. The supervisory methodology and approval process will continue to be refined as the regime progresses through its first year of implementation.

ACCOUNTING FOR BUSINESS COMBINATIONS

As concluded by the MacKay Task Force, Canadian financial institutions are placed at a competitive disadvantage in North America by the significant differences in Canadian and U.S. accounting standards for mergers and acquisitions (i.e., "business combinations").

OSFI is concerned that accounting rules should not be a factor in management decisions on the rationalization of financial institutions in North America. Under Canadian rules, accounting for many such mergers and acquisitions results in lower reported earnings and returns on equity than if they were completed under U.S. accounting rules. While the best solution is for accounting standards setting bodies to harmonize rules, the Task Force recommended that the Superintendent be ready to use his authority to put in place special accounting rules if these bodies could not act in a timely manner.

During the summer of 1998, OSFI carried out extensive consultations on this issue. Both written and verbal responses supported OSFI's initiative to develop and release interim standards. The temporary use of the U.S. approach was the alternative most favoured by respondents.

OSFI has consistently maintained that the preferred solution would be for the Accounting Standards Board (AcSB) to deal with the competitive disadvantages faced by the financial institutions by amending its standard. In September 1998, after discussions with the AcSB and the Canadian Institute of Chartered Accountants, OSFI agreed to hold in abeyance any move on its part to prescribe special accounting rules for mergers and acquisitions while these accounting bodies committed to an accelerated process to address the competitive imbalance by the end of 1999.

OSFI has been actively monitoring the process, urging the adoption of interim solutions in advance of full harmonization. The Office, however, is in a position to act should the standard-setting process fail to deal adequately and expeditiously with the issue.

PERFORMANCE MEASURES

The development of a meaningful measure to gauge how OSFI's activities affect the competitive nature of Canada's financial marketplace is a complex challenge. Many of the interrelated variables that such a measure would encompass are subjective in nature, and the formal definition of some of the variables would involve public policy considerations that extend beyond OSFI's prudential mandate.

OSFI has reviewed the work of a number of organizations on the subject of regulatory impact, in an effort to find a mechanism for measuring the impact of its own regulatory activities on competition in the Canadian marketplace and the competitiveness of Canadian institutions. Nothing suitable has yet been found, and OSFI will be commissioning further research in this complex area. Results will be reported as they become available.

David Gourlay and Wilma van Norden of the Financial Institutions Group, Vancouver

Cost-Effectiveness

WE MAINTAIN A FULL AND OPEN DIALOGUE WITH OUR STAKEHOLDERS ON THE COSTS AND BENEFITS OF OUR WORK.

In addressing the need to be cost effective, OSFI has implemented a number of initiatives. The goal of these initiatives is to make sure that the Office continues to provide value to stakeholders, and that costs are fairly allocated among supervised institutions and pension plans.

Martial Fortin, Jim Dolan and Micheline Appolon of the User Pay Task Force, Ottawa

ACCOMPLISHMENTS AND INITIATIVES

OSFI recovers its expenses for the regulation and supervision of financial institutions through an annual assessment process and now through user fees. Expenses associated with the supervision of pension plans are recovered by means of an annual fee charged to plan administrators. The details of the expenditures in 1998–99 are provided in Annex 1.

USER FEES

The regulations implementing the user fees were passed in December 1998. OSFI released a communique that month informing stakeholders that user fees for selected activities would come into effect on January 1, 1999. The communique also indicated that in the future there would be a second phase of the user pay program, to introduce fees for an additional number of services. This second phase is expected to consider penalty fees for late or erroneous filings and user fees for services requested by administrators of private pension plans. As well, this phase will evaluate the fairness of OSFI's current assessment of fees to financial institutions. The communique also indicated that OSFI will consider introducing fees or assessment surcharges to recover the additional costs associated with enhanced supervision directly from problem institutions.

NEW BUSINESS MANAGEMENT MODEL

The business planning process was redesigned during 1998–99. Using the OSFI Strategic Plan, full business plans were developed for all cost centres. To facilitate this process, new business planning software was designed and implemented. Looking to the current year (1999–2000), an improved quarterly review of financial plans is being implemented.

TIME REPORTING SYSTEM

An improved Time Reporting System was developed in 1998–99. The data collected will be used to allocate the cost of regulatory and supervisory activities to the various industry sectors (passed through as assessments to the industry), and to support the user pay regime, i.e., to verify existing fees for services, and to set new fees.

Looking ahead, data collected by the Time Reporting System will be used for a wide-ranging study of OSFI's methodology for recovering costs. This study is expected to begin in 1999–2000.

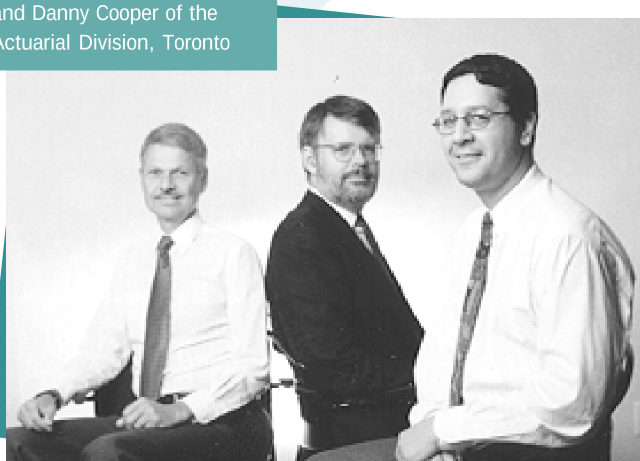
PERFORMANCE MEASURES

OSFI continues to review 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; and
- a comparison of costs to other jurisdictions.

In addition, in conjunction with its efforts to find an appropriate mechanism for measuring its impact on competition, OSFI has been seeking ways to measure the direct and indirect costs of regulation and supervision to the institutions and pension plans that must comply with OSFI's initiatives. Further research is required in this area and will be undertaken by OSFI in 1999–2000.

Gerry Stibbard, David Gourlay and Danny Cooper of the Actuarial Division, Toronto



Mélanie Pilote, Jean-Guy Lapointe and Denis Therrien, Actuarial Division, Ottawa

Quality

WE CONTINUALLY IMPROVE THE KNOWLEDGE AND SKILLS OF OUR PEOPLE AND THE QUALITY OF OUR PROCESSES AND SYSTEMS TO MEET THE CHALLENGES OF A RAPIDLY CHANGING ENVIRONMENT.

Quality reinforces and supports all of OSFI's other strategic objectives. In its pursuit of Quality, the Office has undertaken a number of initiatives, as discussed below. These initiatives seek to capitalize more effectively on the human resource and operational strengths of OSFI and its people.

ACCOMPLISHMENTS AND INITIATIVES

EMPLOYER OF CHOICE

The rapid changes occurring in Canada's financial sector required OSFI to change its organizational structure and to improve work and management practices.

These changes created opportunities for advancement, allowing staff to assume more responsibility and broaden their experience. Coupled with an emphasis on continuous learning – in both formal settings and on the job – OSFI continues to work towards its goal of becoming an "employer of choice."

A number of key initiatives were involved in these changes. First, a more flexible organization structure was created, with most divisions reorganized and most OSFI employees assigned to tasks that were new or substantially revised. The role of divisions was changed and smaller teams were created. As well, the Winnipeg Office was closed, with the work reassigned to other groups. New functional and industry specialists groups were formed into a Specialist Support Sector. It is expected that these specialist groups will continue to evolve and grow to meet OSFI's changing demands.

Hélène Roberge, Louise Desjardins and Russell Yeoman of the Professional Development and Training Division

In seeking to become a learning organization, OSFI is developing a comprehensive suite of training and self-learning programs, closely linked to on-the-job requirements, recruiting, and career planning. These programs seek to respond to the needs of OSFI employees in both technical and non-technical areas. Training budgets have been increased, with a commitment to provide a minimum of five days training per year per employee.

OSFI is also encouraging a coaching/facilitating style of management. With smaller divisions, managers can now work more closely with their staff. Responsibilities are better defined throughout OSFI, and goal commitment documents are now commonly used in planning. As well, OSFI's values of commitment, teamwork, professionalism and integrity have been articulated and steps are being taken to incorporate them into our work on a day-to-day basis.

HUMAN RESOURCE MANAGEMENT

To link the management of human resources to the OSFI Strategic Plan, OSFI has developed a medium term plan entitled *Your Vision – Our Mission* which provides linkages and direction for the continuing evolution of human resource management programs.

Employee mobility between sectors and divisions has been facilitated by appointing management personnel to levels rather than positions. A rotation program has been started. The Career Management Program, which recruits new employees directly from universities and manages the early stages of their careers through on–the–job and external training, was enhanced with additional participants and more program development.

As part of an increased emphasis on performance management, the performance evaluation process was improved and performance pay was put in place at all levels of the organization, with effect from April 1, 1999 based on performance in 1998–99.

A project to develop competency profiles for all jobs at OSFI was initiated and should be completed in the next two to three years. Competency profiles are expected to enhance the Office's ability to recruit candidates – both internally and externally – for vacant positions.

A comprehensive Employee Opinion Survey was carried out in 1997 to establish a benchmark for periodic assessment of employee satisfaction at OSFI. Since then, an Employee Advisory Committee has made recommendations for improvements at OSFI to respond to the results of the survey. Work has begun on the next survey, scheduled for late 1999. Its results will be reported in the 1999–2000 Annual Report.

SERVICE LEVEL AGREEMENTS

As part of the Office's development of performance standards and measures, the Information Technology (IT) Division has begun to implement Service Level Agreements (SLAs) with the other OSFI divisions that are its "customers." Within the SLA initiative, the IT Division identified 10 core services that it is able to provide, given the resources available. For each core service, specific service levels or standards were established, together with tracking mechanisms and measurement tools.

Rachel Grégoire, Michel Poirier (standing), Arminda Serpa and Marc Soulière of Human Resources Management, Ottawa

In 1999–2000, the IT Division will introduce SLAs to all OSFI divisions, starting with a pilot in the first two quarters of the year, but with full office implementation over the final two quarters. Implementation will involve negotiation with individual divisions or sectors to identify specific services and/or service levels; awareness sessions with all OSFI staff; implementation of tools and reports to measure performance; and continuous refinement of service delivery. The SLAs will be re–visited and re–negotiated on an annual basis as part of the Office's business planning process.

YEAR 2000 - INTERNAL PREPAREDNESS

As previously described, OSFI has encouraged and supported Canadian financial institutions in their efforts to address Year 2000 readiness issues. Similarly, OSFI is readying its own internal preparedness for the Year 2000. A Year 2000 task force was established to develop and test its business resumption plan. This plan addresses OSFI's requirements for recovering from any possible business disruption caused by a Year 2000–related failure. The plan identifies business–critical services, and the human, financial and other resources required to provide these services during a crisis period.

Carole Gagnon, Jeff Miller, Helen McDermott and Marc-André Gaudreau of the Financial Analysis and Data Management Division, Ottawa

OSFI has provided the Treasury Board of Canada with a report outlining OSFI's adherence to Year 2000 standards regarding its internal information technology infrastructure.

CORPORATE INFORMATION DATABASE

Considerable progress was made during 1998–99 in developing a database of non-financial, or "corporate" information on all federally regulated financial institutions, to complement OSFI's existing financial reporting and analysis database applications.

Currently scheduled for completion in the fall of 1999, this new database will provide the entire organization with ready access to accurate corporate information, replacing a number of existing (and often duplicative) stand-alone, limited-access electronic and paper-based systems. Already the application is proving its value, recording all significant events (such as incorporations, amalgamation, name changes, and dissolutions) affecting institutions. It also feeds data to other internal systems, including the Time Reporting System and some of the performance measures the Office is now using.

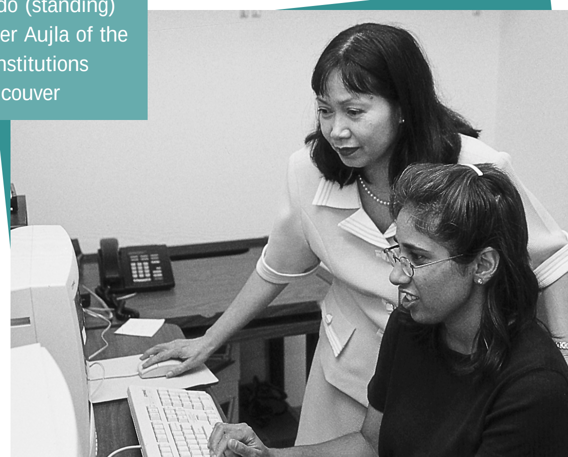
PERFORMANCE MEASURES

To measure important elements of quality, OSFI will continue developing two measures:

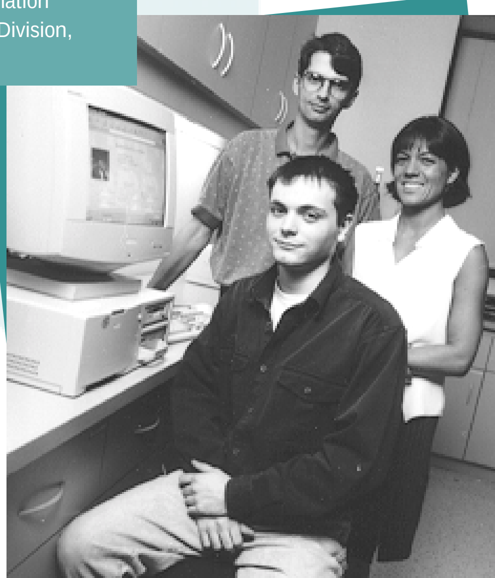
Employee Satisfaction, which will be assessed by a second Employee Opinion Survey scheduled for late 1999. The survey results will be bench-marked for comparative purposes against our first survey completed in 1997.

Achievement of Core Competencies will be measured once competency profiles have been established for specific jobs in the organization. Outside consultants have been retained to assist in this endeavour. The first steps in this project, the creation of an OSFI competency dictionary and the development of core competencies for administrative assistants and the Private Pension Plans Division, will be completed in 1999–2000.

Another quality performance measure, the External Service Quality Index, was planned to evaluate OSFI's responses to requests for services, rulings, and approvals outside the general supervisory process. This measure has been deferred, pending the introduction of a programme to streamline aspects of the Registration and Approvals process, consistent with the recommendation of the MacKay Task Force.



Judy Orlando (standing) and Narinder Aujla of the Financial Institutions Group, Vancouver



Yves Quinty, Carol Deavy and Eric Boisvert (seated) of the Information Technology Division, Ottawa

John Kmetic (standing), Jean-Claude Ménard and Michel Montambeault of the Office of the Chief Actuary, Ottawa

OFFICE OF THE CHIEF ACTUARY

The Office of the Chief Actuary (OCA) has responsibilities that are significantly different from those of the other sectors within OSFI. Rather than playing a regulatory or supervisory role, the OCA provides actuarial services for a variety of public insurance and pension programs. These include the Canada Pension Plan (CPP), Old Age Security and pension and benefits plans covering members of the federal Public Service, the Canadian Forces, the Royal Canadian Mounted Police, federal judges and Members of Parliament.

The OCA prepares statutory actuarial reports on the financial status of the plans and provides actuarial advice on the design, funding and administration of these plans to the responsible government departments. The clients include Human Resources Development, Finance, Treasury Board, Public Works and Government Services, the Canadian Forces, the RCMP and Justice.

In December 1998, the Seventeenth Actuarial Report on the CPP was tabled in Parliament. It was then formally reviewed by a panel of three experienced independent actuaries, who issued their report in April 1999. Both of these reports confirmed that changes contained in Bill C-2 have put the Plan in a financially stable position. (Bill C-2, *An Act to Amend the Canada Pension Plan*, became law in 1997, and included changes to benefit eligibility, contribution levels, and investment policies of the Plan.) The review panel also made several suggestions for improving future actuarial reports on the CPP, which are under consideration.

Statutory actuarial reports were completed on several public sector plans, including the Fourth Actuarial Report on the Old Age Security Program. In addition, the OCA was actively involved in the assessing the cost and administrative implications of significant changes proposed to the Public Service, Canadian Forces and RCMP pension plans.