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OSFI BSIF

The OSFI Pillar

FROM THE OFFICE OF THE SUPERINTENDENT OF FINANCIAL INSTITUTIONS CANADA (OSFI)

OSFI Plan and Priorities for 2011-2014

OSFI has released its Plan and Priorities for 2011-2014. As the core document for OSFI's annual planning cycle, it describes our priorities for the planning period and outlines key challenges and risks.

With the global economy adjusting to new rules and continued uncertainty, the coming years will represent a new set of challenges to the financial institutions and pension plans subject to our oversight. OSFI will be focusing on anticipating and addressing risks resulting from regulatory changes and creating higher standards for effective risk management and governance.

(Continued on page 2…)

Priorities at a Glance: 2011-2014

- ⇒ ***Risks Emanating from the Economy***
- ⇒ ***Risks Emanating from Regulatory Reform***
- ⇒ ***A High-Performing and Effective Work-force***
- ⇒ ***An Enhanced Corporate Infrastructure***

New Senior Director, Insurance Risk Management and Strategy

OSFI is pleased to announce that Jim Doherty will soon be joining us as Senior Director, Insurance Risk Management and Strategy.

He will be responsible for evolving life insurance issues that require strategic as well as policy development and renewal.

He will report to Mark White, Assistant Superintendent, Regulation Sector, and be supported by Stuart Wason, Senior Director, Actuarial Division.

Mr. Doherty joins OSFI from Ernst & Young L.P., where he was a limited partner, as well as a member of the Insurance and Actuarial Advisory Services group and the Life Insurance Practice Leader for Canada.

Previously, he had gained extensive life and health insurance experience in the areas of capital and other regulatory requirements; Canadian GAAP, US GAAP and IFRS; European embedded value; and mergers and acquisitions, through employment with Transamerica Life, Northern Life, Prudential Assurance, and Tower Corporation (formerly Government Life), of New Zealand.

(Continued on page 4…)

Draft revised MCT guideline for P&C insurers

OSFI has released a draft revised Minimum Capital Test (MCT) Guideline for Federally Regulated Property and Casualty Insurance Companies that reflects the proposed changes to the MCT Guideline originally outlined in the December 2010 *Discussion Paper on OSFI's Proposed Changes to the Minimum Capital Test*.

OSFI is proposing to consolidate the Branch Adequacy of Assets Test (BAAT) Guideline, along with the capital-related guidance outlined in the Instructions to the P&C-1 and P&C-2 returns, in order to facilitate reference to capital issues for property and casualty insurance companies.

The MCT Guideline was implemented in 2003, as was the BAAT Guideline in regard to the operations of foreign property and casualty insurance companies operating in Canada on a branch basis. On an ongoing basis, OSFI considers whether changes are required to improve the risk measures, address emerging issues, and encourage improved risk management. The Guidelines provide the framework within which OSFI and provincial regulators assess whether a property and casualty insurance company maintains adequate capital and whether a property and casualty insurance company operating in Canada on a branch basis maintains an adequate margin.

The MCT Guideline describes the capital required using a risk-based formula, and defines the capital that is available to meet the minimum standard. The BAAT Guideline outlines the framework for branches using a risk-based formula for the minimum margin to be maintained by branches, in Canada, and defines the assets that are available to meet the minimum standard.

More details are available on OSFI's website at:
www.osfi-bsif.gc.ca

Today's regulation steers economic ship into tomorrow, says Assistant Superintendent

The following is an excerpt from remarks by Assistant Superintendent Ted Price to the 2011 International Institute of Finance Latin America Economic Forum in Calgary, on March 27, 2011.

I am sure that everyone here has a different perspective on the global financial crisis and the strength of the current recovery, and I am glad to be able to share a Canadian federal regulator's perspective.

Global economies have turned the corner. Since the dark days of the financial crisis, risk in the financial system has dropped. Even so, the recovery is fragile and risks continue to cast a shadow over the financial system.

The recovery still seems young, but markets are two years off their lows. Financial institutions, particularly in Canada, are enjoying pretty heady times. We must all remember that good times cannot last forever, and the challenges faced by many economies could shorten this cycle.

This next phase of the cycle could last for months or years, but it will set the stage for the next crisis. How well we regulate, and business leaders manage, today, will determine whether we steer clear or sail straight into the next storm.

If supervisors and business leaders want to avoid the damage experienced during the last cycle, we will all have to behave a bit differently this time around.

The complete speech is available on the OSFI website at:
www.osfi-bsif.gc.ca

Ted Price,
Assistant Superintendent,
Supervision Sector

Plans & Priorities (continued from page 1…)

We will be paying particular attention to the effects of the implementation of international accounting rule changes and of Basel III capital adequacy requirements. In addition, OSFI will continue to work on reform of the capital framework for insurance companies and moving toward a more market-consistent approach.

As we enter 2011-2012, we will continue our contribution to a strong domestic financial system, in the face of a volatile global economic climate and transformational international regulatory changes.

The full document is on the OSFI website at:
www.osfi-bsif.gc.ca

Prudence and focus required to avoid complacency, says Superintendent

The following is an excerpt from remarks by Superintendent Julie Dickson to the 2011 Financial Services Invitational Forum in Cambridge, Ontario, on April 27, 2011.

Julie Dickson, Superintendent of Financial Institutions

As noted by the Financial Stability Board, financial system risks remain high. Sovereign risks in some countries have crystallized. Weaknesses are evident in some banking systems, and the fiscal position of a number of countries remains a major source of concern. Risks of sudden changes in funding conditions, credit losses, and yield curves stress the need for a high degree of prudence by banks.

At the same time, the low interest rate environment is leading investors to search for yield. This search can encourage the development of complex financial products that increase exposure to liquidity risk. The Financial Stability Board has been monitoring this and has released a paper on the risks associated with certain exchange traded funds that have arisen primarily in Europe.

We are also witnessing a two-track economic recovery – very fast in emerging economies, and rather protracted in many developed economies. This is creating challenges for bank supervisors at both ends of the spectrum. Bank supervisors in emerging market economies have to be on the alert for asset price inflation and excessive credit growth, while supervisors in other countries are more concerned about building capital levels in banks. On top of this, the removal of quantitative easing in the U.S., as well as concerns about the U.S. fiscal situation are also putting us in uncharted territory.

In Canada, because our banking system generally fared better that others, we need to be on the lookout for complacency. Indeed, because the Canadian system has performed well there may be a tendency to think that only others need to learn lessons from the crisis, or to say that the wide array of new measures applicable to Canadian banks unfairly penalizes them. Past success does not guarantee future success.

I think we need to be prudent in how we approach changes to the regulatory system. We also need to be cautious in comparing capital proposals that may be based on very different assumptions and definitions. Finally, we would be doing ourselves a disservice to assume that, by setting higher capital levels, the rest will look after itself.

For any capital regime to work, supervisory agencies need to have the real world expertise and specialization to oversee market practitioners, mandates that are focused on the important and specialized function of supervision and regulation, and the will and operational independence to act. But these initiatives require a lot more work than setting a capital rule, and have attracted much less academic attention. That needs to change.

The complete speech is available on the OSFI website at:
www.osfi-bsif.gc.ca

External peer review panel on 25th CPP Actuarial Report

The Office of the Chief Actuary of Canada (OCA) has released the findings of an external peer review panel commissioned to review the 25th Actuarial Report on the Canada Pension Plan (CPP).

The external panel's findings confirm that the work performed by the OCA on the Report meets all professional standards of practice and statutory requirements. The panel states that the assumptions, both individually and in the aggregate, are within a reasonable range, in accordance with the Canadian Institute of Actuaries' standard, and that the methods used are also reasonable.

Produced every three years, the Actuarial Report on the CPP is considered by the federal and provincial finance ministers when reviewing and making recommendations regarding the Plan. The external peer review process was first introduced in January 1999.

CPP Actuarial Reports and independent reviews are available on the OSFI website at:
www.osfi-bsif.gc.ca

Draft Stress Testing Guideline for Defined Benefit Pension Plans

OSFI has released a Draft Stress Testing Guideline for Plans with Defined Benefit Provisions.

This guideline sets out OSFI's expectations on the use of stress testing by plan administrators for their plans. Although there is no regulatory requirement for an employer to conduct stress testing on their pension plan, it is viewed as a positive way to identify and manage risks. OSFI does not expect stress testing reports to be filed with our office. When OSFI assesses a pension plan's overall level of risk, evidence that the administrator uses stress testing would support good controls with respect to asset management.

Stress testing involves the simulation of different shocks and scenarios that could impact a plan's funding policy, investment policy, and benefit levels. It may also identify risks to the employer's overall ability to fund a plan.

The techniques within stress testing vary but typically include sensitivity and scenario testing as well as reverse stress testing.

Stress testing is a key risk management tool for plan administrators to use in managing the risks in their pension plans. It makes the administrator aware of possible adverse events that could impact their pension plan and can lead to decisions that may be required to minimize or avoid unfavourable outcomes. It could also assist employers in determining what may be required in order to ensure that the current benefits provided by a plan can continue to be supported. The process provides forward-looking results that will assist administrators in their decision-making process.

Key benefits of stress testing are that it may:

- Provide an understanding of the possible downside of various investment strategies,
- Demonstrate the impact of various scenarios, including those that could increase the employer's funding requirements even to a level that could jeopardize the viability of the plan,
- Identify risks that are outside of regular business practices and strategies,
- Assist in quantifying the risks in a pension plan,
- Provide information on the impact of a change in a risk factor,
- Assist in the decision-making process, and
- Assist in mitigating otherwise unforeseen negative impacts on the plan.

In order to take advantage of the benefits of conducting stress testing, administrators should be willing to evaluate possible scenarios openly, including discussing the results and risks openly, as well as possible actions that may be required in order to mitigate risks to the pension plan.

More information is available on the OSFI website at: **www.osfi-bsif.gc.ca**

New Senior Director (continued from page 1…)

He has served as the Appointed Actuary and External Reviewer for a number of life insurance companies.

In addition to being a graduate of the University of Waterloo (Bachelor of Mathematics), Mr. Doherty is a Fellow of the Canadian Institute of Actuaries (CIA), of the Society of Actuaries (SOA), and of the New Zealand Society of Actuaries. He currently chairs the CIA Board Task Force on IFRS 4 Phase II, and is Vice-Chair of the Committee on International Relations. In the past, he has been actively involved with the Education and Examination process and many other roles with both the CIA and the SOA.

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The OSFI *Pillar*

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For a free subscription, or to provide feedback, please e-mail OSFI Communications and Consultations at thepillar@osfi-bsif.gc.ca.

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