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

OSFI Annual Report
2017-2018

OSFI
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Canada

Office of the Superintendent of Financial Institutions Canada

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Cat. No. IN1-2018E-PDF ISSN 1701-0810

About OSFI

- The Office of the Superintendent of Financial Institutions (OSFI) is an independent federal government agency established in 1987.
- OSFI regulates and supervises more than 400 federally regulated financial institutions (FRFIs) and 1,200 private pension plans to determine whether they are in sound financial condition and meeting their regulatory and supervisory requirements.
- These include all banks in Canada and all federally incorporated or registered trust and loan companies, insurance companies, fraternal benefit societies and private pension plans.
- Although OSFI plays an essential oversight role, the executive management and boards of directors of institutions and trustees of private pension plans are responsible for their success or failure.
- OSFI's approach to supervision is risk-based to reflect the nature, size, complexity and risk profile of an institution. Financial institutions must be allowed to take reasonable risks and compete effectively. OSFI seeks to balance competitiveness with financial stability, and international standards with Canadian market realities.
- OSFI reports to Parliament through the Minister of Finance and works closely with its federal partners, including the Department of Finance, the Bank of Canada, the Canada Deposit Insurance Corporation and the Financial Consumer Agency of Canada.
- OSFI's Audit Committee, composed of three independent members and the Superintendent, provides objective advice and recommendations to the Superintendent regarding the adequacy and functioning of OSFI's governance, risk management and control practices.
- OSFI recovers its costs, which in 2017-2018 totalled $157 million. OSFI is funded mainly through assessments on the financial institutions and private pension plans it regulates and a user-pay program for legislative approvals and other select services.
- The Office of the Chief Actuary, which is an independent unit within OSFI, provides actuarial valuation and advisory services for the Canada Pension Plan, the Old Age Security program, the Canada Student Loans Program, and other public sector pension and benefit plans.
- As of March 31, 2018, OSFI employed some 750 people in offices located in Ottawa, Montréal, Toronto and Vancouver.

Superintendent's Message

Financial regulators and supervisors around the world often wonder when the next crisis will emerge. It is always a question of 'when', not 'if'.

In early 2018, the Organisation for Economic Cooperation and Development warned that the world's financial system is as dangerously stretched today as it was at the peak of the last crisis, but this time authorities may have fewer policy defences left to respond.

There are no shortages of issues that keep OSFI and its counterparts up at night. These range from cyber security and cryptocurrencies to trade protectionism and other geopolitical concerns. While we cannot predict exactly when the next crisis will be or what it will entail, we must remain vigilant.

Complacency carries greater risk for countries like Canada, where financial institution failures are rare and whose financial sector performed relatively well during the global financial crisis. It can be a challenge to persuade someone of the dangers of potential risks when they have not experienced the consequences firsthand.

Since the financial crisis, OSFI has taken a series of steps to make our system more resilient. We acted by raising both the quantity and quality of capital that institutions were required to hold. We also strengthened liquidity requirements, and developed new guidance in other key areas such as operational risk, risk management and compliance.

During the 2017-2018 reporting period, we took action to reinforce a strong and prudent regulatory regime in several areas.

We strengthened underwriting by federally regulated lenders by updating our Guideline B-20 – *Residential Mortgage Underwriting Practices and Procedures*. The updates set a new minimum qualifying interest rate for uninsured mortgages; require lenders to enhance their loan-to-value (LTV) measurement and limits; and place restrictions on certain lending arrangements that appear designed to circumvent LTV limits.

As part of our capital requirements regime for Canada's largest banks, we announced our intention to publicly set the *Domestic Stability Buffer* in a letter to industry that will be posted to OSFI's website each June and December. Not only does this move increase transparency around the capital the banks have set aside, it also seeks to better inform the market on the possible risks to the system that OSFI has identified.

With the goal of clarifying OSFI's requirements around governance, we undertook a comprehensive review of our expectations for boards of directors and revised our *Corporate Governance Guideline*. The key amendments include a clearer delineation of board and senior management responsibilities.

We also released updated versions of our *Life Insurance Capital Adequacy Test* (LICAT) and *Minimum Capital Test* (MCT) guidelines, effective January 1, 2018, for life and property and casualty insurers, respectively.

The updated versions reflect further refinements, calibration adjustments and clarifications in respect of inquiries or comments received from insurers and stakeholders. In 2019, our regulatory capital framework for residential mortgage insurance will include a new approach for capturing credit risk. Our capital requirements will also be documented in a new, separate capital guideline for mortgage insurers.

During this reporting period, the Financial Stability Board added the Royal Bank of Canada (RBC) to its list of designated global systemically important banks, or G-SIBs. RBC is already subject to OSFI's framework for domestic systemically important banks (D-SIBs) and these requirements are modelled on the G-SIB framework. Consequently, RBC is well positioned to meet the G-SIB requirements starting in January 2019.

Our people and partners

Regulating and supervising financial institutions and private pension plans relies on the dedication of employees who are knowledgeable, passionate and determined to keep Canada's financial system strong and resilient. Our new *Human Capital Strategy* is helping us attract, retain and develop our people. It is focused on five key areas: leadership development, talent management, learning and development, culture and community building, and enterprise change management.

In February 2018, we were saddened to learn of the death of Michael Mackenzie, who served as OSFI's first Superintendent from 1987 to 1994. Superintendent Mackenzie was a strong proponent of a "tripartite oversight" concept. This involved boards of directors of federally regulated financial institutions, external auditors and actuaries, along with OSFI, participating in the development of a thorough and balanced oversight system. OSFI continues to benefit from his legacy, as close relationships and frequent communication among these parties continue to be central to how we accomplish our work.

During the 2017-2018 fiscal year, OSFI celebrated its 30th anniversary and its many successes.

OSFI's mandate is to protect depositors, policyholders, financial institution creditors and pension plan members, while allowing financial institutions to compete and take reasonable risks. We do this by developing guidance on risk management and mitigation, assessing the safety and soundness of financial institutions, and intervening promptly when corrective actions need to be taken. By remaining focused on that mandate, by having the will to act, and by resisting complacency, I believe that OSFI will continue to build a record of success for the next 30 years.

Jeremy Rudin

Mandate

Fostering sound risk management and governance practices

OSFI advances a regulatory framework designed to control and manage risk.

Supervision and early intervention

OSFI supervises federally regulated financial institutions and pension plans to determine whether they are in sound financial condition and meeting regulatory and supervisory requirements. OSFI promptly advises financial institutions and pension plans if there are material deficiencies, and takes corrective measures, or requires that they be taken to expeditiously address the situation.

Environmental scanning linked to safety and soundness of financial institutions

OSFI monitors and evaluates system-wide or sectoral developments that may have a negative impact on the financial condition of federally regulated financial institutions.

Taking a balanced approach

OSFI acts to protect the rights and interests of depositors, policyholders, financial institution creditors and pension plan beneficiaries, while having due regard for the need to allow financial institutions to compete effectively and take reasonable risks. OSFI recognizes that management, boards of directors and pension plan administrators are ultimately responsible for risk decisions, and that financial institutions can fail and pension plans can experience financial difficulties resulting in the loss of benefits.

In fulfilling its mandate, OSFI supports the government's objective of contributing to public confidence in the Canadian financial system.

Benefit to Canada

OSFI's regulation and supervision activities play a key role in contributing to public confidence in the Canadian financial system. A properly functioning financial system makes a material contribution to Canada's economic performance, and inspires a high level of confidence among consumers and others who deal with financial institutions.

Performance against Priorities 2017-2018

OSFI identified five priorities for 2017-2018 to assist in achieving its mandate. This section reports key accomplishments under each priority. More details are available in subsequent chapters.

Priority A: Tighten the link between effort at OSFI and results in the field

Steps Taken

- Developed tools to support benchmarking and consistency of approach in OSFI's supervisory methodology.
- Completed pilot risk culture reviews for the two largest life insurance companies.
- Conducted a review of the governance of domestic retail sales practices across the six domestic systemically important banks (D-SIBs) and the related institutional risk culture.
- Initiated work to enhance OSFI's ability to assess how risk culture and other drivers of behaviour support or undermine effective risk management across a range of institutions.

Priority B: Strengthen our ability to anticipate and respond to severe but plausible risks to the Canadian financial system

Steps Taken

- Issued a revised *Mortgage Underwriting Practices and Procedures* guideline (B-20).
- Finalized and implemented the *Life Insurance Capital Adequacy Test* (LICAT) guideline.
- Revised the *Capital Adequacy Requirements* (CAR) guideline regarding capital treatment of allowances to align with the adoption of IFRS 9 by deposit-taking institutions.
- Completed consultation on the draft *Total Loss-Absorbing Capacity* (TLAC) guideline, including the proposed treatment of TLAC holdings.
- Developed a new public approach to announcing the *Domestic Stability Buffer*, a discretionary capital tool used to adjust for uncertainty arising from key vulnerabilities.
- Published a draft version of the 2018 *Minimum Capital Test* guideline for consultation. Amendments improved consistency and clarity of the capital framework for P&C insurers.
- Reviewed reinsurance practices and drafted revisions to existing guidelines (e.g. *Sound Reinsurance Practices and Procedures* (B-3) and *MCT* guideline).
- Collaborated with the Bank of Canada on a macro stress test to explore the potential impacts of a severe but plausible macroeconomic stress scenario.
- Completed a cyber security cross-system review to assess the characteristics of banks' cyber resiliency and identify potential weaknesses in cyber risk identification, prevention, detection, response, and recovery capabilities.

Priority C: Reinforce our principles-based guidance and supervision

Steps Taken

- Issued for comment a draft revised version of the *Corporate Governance Guideline* in November 2017. The revised guideline consolidates all expectations of the board of directors.

- Incorporated proportionality principles in the final *Enterprise-wide Model Risk Management for Deposit-Taking Institutions* guideline (E-23) in September 2017.

- Consulted with industry to prioritize issues that impact small- and medium-sized institutions.

Priority D: Influence international guidance, standards and reforms with a view to implementing them in the context of what is best for Canada

Steps Taken

- Actively participated in the finalization of the Basel 3 reforms announced in December 2017 aimed at improving the risk sensitivity of capital standards and comparability of capital ratios.

- Replaced the existing Basel 1 capital floor with a more risk-sensitive capital floor, based on the Basel 2 framework, as an interim step toward implementation of the Basel 3 capital floor in 2022.

- Monitored implementation of IFRS 9 *Financial Instruments and Disclosures* guideline by financial institutions to ensure high-quality adoption of the standard.

- Issued a guideline outlining OSFI's expectations on the implementation of revised Basel Pillar 3 disclosure requirements for the reporting period ending October 31, 2018.

- Initiated planning on the implementation of IFRS 17, including issuing an advisory on IFRS 17 *Transition and Progress Report Requirements* for federally regulated insurers.

- Participated in the International Association of Insurance Supervisors (IAIS) efforts to develop guidance for insurance regulators and to design and implement a new international insurance capital standard.

Priority E: Set and meet high standards for managing our own resources

Steps Taken

- Completed the rollout of a modern electronic document records management system to enhance the management of information assets.

- Strengthened enterprise information management governance related to data stewardship.

- Implemented a cyber security strategy and action plan to identify and manage cyber security incidents as well as reduce risk of data loss and system downtime.

- Launched a standing committee of senior management accountable to the Executive Committee called the Operating Committee, mandated to make decisions on key operational matters.

- Developed an enterprise change management program, including a methodology, lexicon, suite of tools and training program to manage change effectively.

- Created a leadership development program to strengthen leadership and people management capabilities.

- Consulted employees to develop a new pride and recognition program.

- Modernized facilities for improved accessibility.

- Demonstrated fiscal discipline by budgeting for the human and material resources necessary to meet our mandate while being attentive stewards of financial resources.

Looking forward

During the 2018-2019 fiscal year, OSFI will be focused on the areas of capital rule-making for both deposit-taking institutions and insurers, accounting implications related to the implementation of new financial reporting standards, reinsurance practices and corporate governance for financial institutions. OSFI is also rethinking its role in the management of cyber risk by financial institutions in light of the Government of Canada's plan to create the Canadian Cyber Security Centre.

OSFI is monitoring the implementation of major guidance initiatives and is reviewing its crisis preparedness framework in partnership with other federal agencies and departments. We are refining our supervisory processes, tools and enabling technology, and are developing and implementing related training modules.

OSFI is striving to enhance its effectiveness and efficiency in the areas of strategic planning and change management, human resources and communications. A new approach to planning is being implemented, which will involve changes to governance, processes and tools. It will also include the design of a new IT solution that will help prioritize work and resource allocation.

OSFI is developing an enterprise change management framework to improve its capability to lead and manage change. In developing its employees, OSFI's multi-year Human Capital Strategy is focusing on leadership development, talent management, learning and development, culture and community building, and enterprise change management.

Finally, external communications initiatives are being launched to raise awareness and understanding of OSFI's mandate and role.

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Federally Regulated Financial Institutions

OPERATING ENVIRONMENT

Conditions in Canada have been positive for most federally regulated financial institutions, including profitability, economic and financial stability and benign credit conditions. At the same time, they continue to face competitive pressure to innovate products and services, expand into new markets, increase lending, enhance efficiencies and embrace new technologies. The unrelenting changes in the financial services industry contribute to an environment of new and rapidly evolving risks. In response, OSFI proactively monitors and assesses the potential impact of a variety of risks on an ongoing basis.

The main risks to the financial institutions that OSFI regulates and supervises include elevated household debt and asset imbalances, which would include Canadian housing markets and commercial real estate. OSFI has assessed the risk associated with household debt and asset imbalances in the housing market as elevated. OSFI has implemented a number of changes to its mortgage underwriting guideline B-20 to ensure sound underwriting practices are in place at all financial institutions, thereby contributing to resiliency. Notable changes included greater due diligence and documentation for verifying income, a new minimum qualifying interest rate for uninsured mortgages, and adjustments to loan-to-value limits in markets that have experienced rapid price changes.

Also notable in the current environment is the emphasis by financial institutions on cost efficiency and product innovation, which has heightened their reliance on technology. This increased reliance across all businesses and the greater dependency on centralized systems contributes to technology risk. Financial institutions require increasingly robust IT risk

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management frameworks, increased cyber security readiness capability, enhancement of governance practices and expanded IT risk awareness and reporting practices. OSFI continuously assesses financial institution preparedness for and the potential impact from technology risk.

Catastrophic risk events, and climate change more generally, have been identified as areas requiring increased attention. The pace of change in this area presents a growing challenge for risk managers who model the potential impacts and provide guidance to their firms. OSFI and industry need to keep abreast of developments in this area and determine appropriate responses that will support financial stability.

More broadly, OSFI is also focused on evaluating the potential impact on financial institution stability from a variety of other risks, including financial stress emanating from market volatility, increased trade protectionism and financial instability in other markets and parts of the world.

RISK ASSESSMENT AND INTERVENTION

Review by Sector

Deposit-taking Supervision

The Canadian deposit-taking industry comprises six large domestic banks designated as domestic systemically important banks (D-SIBs) and many smaller deposit-taking institutions (On November 21, 2017, Royal Bank of Canada was designated a global systemically important bank (G-SIB) by the Financial Stability Board). The six largest banks account for about 90 percent of total assets held by federally regulated deposit-taking institutions. Their diversified business lines extend beyond traditional deposit-taking and lending activities to trading, investment banking, wealth management and insurance. In addition to their primary domestic focus, these large banks operate in many other countries.

The remaining 10 percent of assets are held by small- and medium-sized institutions with various market and business strategies such as mortgage lending, commercial real estate lending and credit card lending.

Canadian banks reported capital ratios well above the minimum requirements during 2017-2018. The D-SIBs remained above the eight percent capital requirement (reflecting a minimum seven percent plus a one percent D-SIB capital surcharge), and small- and medium-sized banks also reported capital ratios above the minimum level of seven percent.

Overall, income remained stable or growing at deposit-taking institutions. Return on equity for the industry was about 15 percent as at 2017 fiscal year end, primarily due to solid net income generation and a mainly favourable credit environment.

More detailed financial information on the institutions subject to OSFI regulation and supervision is available through the Financial Data application on the OSFI website.

OSFI closely monitored economic, financial and other risks facing deposit-taking institutions, including system-wide or sector developments that could have a negative impact on their financial condition. A key focus has been addressing risks

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and vulnerabilities related to mortgage lending, which continue to be elevated given low lending rates and significant increases in household debt, particularly mortgage debt. Should an economic downturn lead to a meaningful fall in housing prices, there is a risk that lenders could face material credit losses. Recognizing the risks related to mortgage lending, OSFI implemented changes to its mortgage lending guideline (B-20) to ensure lenders remain vigilant in their underwriting practices.

Other key areas of supervisory focus included bank sales practices, cyber security risks, implementation of new expected credit loss accounting (IFRS 9), and liquidity risks.

Insurance Supervision

Life Insurance

The life insurance industry consists of three large institutions and more than 70 domestic companies and foreign branches. The large insurers account for more than 90 percent of the assets and have operations in Canada, the U.S., Europe and Asia. They offer a broad range of wealth management, life and health insurance products through a number of distribution channels. The smaller insurers are more restricted in product breadth and distribution.

Effective January 2018, the *Life Insurance Capital Adequacy Test* (LICAT) guideline replaced the *Minimum Continuing Capital and Surplus Requirement* (MCCSR) guideline as the key metric used to assess capital adequacy. The LICAT represents an evolution in OSFI's regulatory capital expectations and is designed to take account of significant changes in the nature and management of risk. It improves the overall measurement of the quality of available capital and incorporates refined techniques in risk measurement.

During the last several years there has been strong growth in the equity markets with increases in interest rates in the U.S. and Canada. While this has alleviated the pressure on insurers with long-term liabilities, it is unlikely rates will rise to pre-2008 levels in the near future. OSFI has observed a small increase in insurers' investment risk profiles as they seek higher yield.

There is a large amount of work to be completed by the insurance industry to accommodate the significant changes to systems, operations, capital requirements and financial reporting required for the implementation of International Financial Reporting Standard 17, also called IFRS 17. Consequently, OSFI will be requiring insurers to provide periodic progress reports. Although LICAT was developed in anticipation of the potential effects of IFRS 17, some modifications may be necessary. OSFI will consult with industry in advance of publishing accounting or capital guidance related to IFRS 17.

The digitization of financial services is creating new competitive challenges for insurers, which are accompanied by increased operational risk, including information risk management exposure and cyber security. Addressing these changes requires expertise and financial resources that may be beyond some insurers' financial capabilities. OSFI will be monitoring developments at insurers as technology evolves.

The aggregate capital ratio for the life insurance industry at 227 percent (under MCCSR) remained unchanged from 2016. The aggregate level has been well above OSFI's minimum requirements for the last several years as companies built up capital in response to market volatility.

Return on equity was 8.4 percent compared to 10 percent in 2016. About 75 percent of net income is attributable to the three large insurers. The decrease in net income and return on equity was driven by one-time charges, including the impact of U.S. tax reform, which was partially offset by favourable experience and market impacts.

More detailed financial information on the institutions subject to OSFI regulation and supervision is available through the Financial Data application on the OSFI website.

Challenges remain as persistently low interest rates make asset/liability management more difficult and put strain on in-force product profitability given that many products cannot be re-priced due to contractual provisions. OSFI is monitoring changes in risk policies to ensure companies adopt appropriate mitigation practices and controls if they move up the risk curve in an effort to enhance return on equity.

Property and Casualty Insurance

The property and casualty (P&C) industry reported significantly higher net income in 2017. Weather and catastrophe-related losses continued to be a key driver for earning volatility, as demonstrated by the significant impact of the Alberta wildfires in 2016. Despite an absence of substantial catastrophes in 2017, profitability was affected by the more frequent but non-catastrophic magnitude weather-related losses.

More detailed financial information on the institutions subject to OSFI regulation and supervision is available through the Financial Data application on the OSFI website.

A key measure of core profitability is the 'combined ratio', which measures the revenue from premiums relative to the sum of claims and expenses. A combined ratio under 100 percent indicates that underwriting profits as premium income exceed claims and expenses. The aggregated combined ratio improved to 97.8 percent in 2017 from 101 percent the previous year.

The Minimum Capital Test (MCT) is the capital metric for Canadian P&C insurers while the Branch Adequacy of Assets Test (BAAT) is used for foreign-owned branch operations in Canada. The industry was well capitalized, with a capital ratio of 257 percent in 2017, well above OSFI's supervisory target of 150 percent.

A comprehensive review of reinsurance practices was a key initiative in 2017-2018. While OSFI recognizes reinsurance as an important risk management tool, certain industry business models rely heavily on reinsurance and result in concentrated counterparty credit risk. Our objective is for institutions to have adequate financial resources and proper risk management practices in place.

OSFI is considering changes to guidelines addressing sound business/financial practices, prudential limits, restrictions and capital adequacy. A consultation was scheduled in the summer of 2018 before the reform of the reinsurance framework is finalized.

Mortgage Insurance

The mortgage insurance industry comprises three participants: two private sector insurers regulated by OSFI, and the Canada Mortgage and Housing Corporation (CMHC), which is a Crown corporation also subject to OSFI oversight.

In 2017-2018, OSFI implemented a new capital framework applicable to the mortgage insurers under the Minimum Capital Test (MCT). This reflects an evolution in OSFI's regulatory capital expectations, and is designed to be more risk-sensitive and responsive to the key drivers affecting the probability and severity of mortgage loan defaults. At December 31, 2017, the average MCT ratio of the private sector mortgage insurers stood at 173 percent and CMHC's MCT ratio was 211 percent (including transitional arrangements under the new framework). Capital for all three insurers remains above their defined operating levels and OSFI's minimum supervisory requirement of 150 percent.

The mortgage insurers displayed strong financial performance during 2017. Total after-tax net income rose by 21 percent from the previous year, reflecting higher earned premiums, increased investment income and lower claims.

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More detailed financial information on the institutions subject to OSFI regulation and supervision is made available quarterly through the Financial Data application on the OSFI website.

The total volume of new business written declined by 18 percent for transactional insurance and by 65 percent for portfolio insurance, reflecting trends in real estate sales volumes, shifting lender demand for portfolio coverage and policy changes. Total insurance in-force declined by three percent to $771 billion (not including CMHC's securitization guarantees).

Despite the favourable financial results and reduced new business volumes, the mortgage insurers remain vulnerable to rising consumer debt levels and the risk of a housing price correction in certain markets. In the event of a significant and sustained increase in mortgage borrowing rates or a significant increase in the unemployment rate, borrowers' repayment capacity may become stretched, potentially elevating the vulnerability of the mortgage insurers to higher claims. OSFI is reviewing stress testing practices and the range of stress scenarios considered by the mortgage insurers in facing these and other key risks.

Supervisory Tools

Managing Risk Effectively

OSFI maintains internal assessment guidance to support its risk-based Supervisory Framework, which considers an institution's inherent business risks, risk management practices (including corporate governance) and financial condition.

OSFI again held annual risk management seminars in 2017-2018 for the industries it regulates (deposit-taking, life insurance, P&C insurance and mortgage insurance) to reinforce the need for strong risk management and to share lessons learned in risk management. The goal of these seminars is to communicate OSFI's expectations in key risk management areas based on detailed work OSFI has undertaken during the prior year. It is also an opportunity to share information on issues being discussed internationally by peer regulators. The seminars offer participants the chance to ask questions of OSFI's senior supervisory and regulatory teams.

OSFI hosted Colleges of Supervisors for five of Canada's largest banks. In line with Financial Stability Board recommendations, the colleges bring together executives from Canadian banks with supervisors from applicable host-country jurisdictions where they do business. OSFI also hosted a supervisory college for a large life insurance company for a similar purpose. In conjunction with the Canada Deposit Insurance Corporation, Crisis Management Groups were also held for the six domestic systemically important banks.

Composite Risk Ratings

The Composite Risk Rating (CRR) represents OSFI's overall assessment of an institution's safety and soundness. There are four possible risk ratings: 'low,' 'moderate,' 'above average' and 'high.' The CRR is reported to most institutions at least once a year (certain inactive or voluntary wind-up institutions may not be rated). Supervisory information regulations prohibit institutions or OSFI from publicly disclosing

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their ratings. As at the end of March 2018, OSFI had assigned CRR ratings of low or moderate to 94 percent, and above average or high to six percent of all CRR-rated institutions.

Intervention Ratings

As described in OSFI's guides to intervention for FRFIs, financial institutions are also assigned an intervention (stage) rating, which determines the degree of supervisory attention they receive. Broadly, these ratings are categorized as: normal (stage 0); early warning (stage 1); risk to financial viability or solvency (stage 2); future financial viability in serious doubt (stage 3); and non-viable/insolvency imminent (stage 4). As at March 31, 2018, there were 28 staged institutions. With a few exceptions, most of the staged institutions were in the early warning (stage 1) category.

REGULATION AND GUIDANCE

OSFI provides a regulatory framework of guidance and rules for federally regulated financial institutions that reflect international minimum standards. OSFI also provides input to the development of federal legislation and regulations affecting regulated financial entities. It comments on accounting, auditing and actuarial standards development, including determining how to incorporate those standards into its regulatory framework. OSFI also participates in a number of international and domestic rule-making activities and groups.

DOMESTIC RULE MAKING

Accounting, Auditing and Actuarial Standards

OSFI's supervision and regulation of financial institutions places strong reliance on the quality of audited financial statements. For this reason, OSFI is proactive in its participation in several domestic and international standard setting and oversight bodies related to Canadian auditing and accounting standards, including the:

- Basel Committee's Accounting Experts Group, which ensures high quality international accounting, audit and ethics standards and practices for banks;
- Canadian Accounting Standards Board's (AcSB) Insurance Transition Resource Group, which provide the AcSB with user and implementation insights;
- Auditing and Assurance Standards Oversight Council (AASOC), which oversees the activities of the Canadian Auditing and Assurance Standards Board (AASB);
- Accounting Standards Oversight Committee (AcSOC), which oversees the activities of the AcSB and the Public Sector Accounting Board (PSAB);
- Canadian Public Accountability Board (CPAB) Council of Governors, which conducts an annual high-level assessment of the CPAB against its mandate;
- Public Interest Oversight Board (PIOB), which oversees the international standard-setting of auditing, ethics and education standards.

OSFI works closely with the Canadian Institute of Actuaries (CIA) and the Actuarial Standards Board (ASB) to ensure that actuarial standards are appropriate and lead to acceptable practice in areas such as valuation, risk and capital assessment at insurance and pension plan entities. In 2017-2018, OSFI participated on several CIA practice committees, the CIA/ASB group on the harmonization of Dynamic Capital Adequacy Testing (DCAT) with insurance companies' Own Risk and Solvency Assessments (ORSA), and joined the ASB designated group updating actuarial standards related to the implementation of the International Financial Reporting Standard (IFRS) 17.

OSFI also contributes to the International Actuarial Association (IAA) work by establishing guidance related to actuarial support for IFRS 17, and the International Association of Insurance Supervisors' (IAIS) Insurance Capital Standard (ICS).

Capital and Liquidity Guidance

Deposit-taking Institutions

OSFI updated its Capital Adequacy Requirements (CAR), the framework for assessing the capital adequacy of federally regulated institutions. These amendments clarified the treatment of allowances in anticipation of the adoption of IFRS 9 in 2018, and followed industry consultation on the projected capital impacts of IFRS 9 implementation.

Capital buffers are an important element of Canada's capital regime and enhance the overall safety and soundness of the Canadian financial system. OSFI adjusted its capital regime to increase transparency around its *Domestic Stability Buffer*, with the aim of ensuring Canada's largest banks are better able to draw on the buffer in periods of stress, rather than engage in activities that may have negative impacts and exacerbate financial instability. OSFI plans to set its *Domestic Stability Buffer* rate in June and December each year through a public posting to its website.

OSFI also completed consultations on the draft *Total Loss-Absorbing Capacity* (TLAC) guideline, which sets out requirements for a D-SIB to maintain sufficient loss-absorbing capacity to support its recapitalization in the event of failure. The final TLAC guidance was published in April 2018 for implementation on September 23, 2018. D-SIBs must fully meet their minimum TLAC requirements by November 1, 2021.

Insurance Companies

In the fall of 2017, OSFI released updated versions of its *Life Insurance Capital Adequacy Test* (LICAT) and *Minimum Capital Test* (MCT) guidelines, effective January 1, 2018, for life and property and casualty insurers, respectively. The updated versions reflect further refinements, calibration adjustments and clarifications in respect of inquiries or comments received from insurers and stakeholders.

In collaboration with the P&C MCT Advisory Committee, OSFI developed a framework for the use of company-specific models to determine capital requirements for P&C insurance companies.

OSFI issued updated versions of two guidelines: *Regulatory Capital and Internal Capital Targets* (A4) and *Own Risk and Solvency Assessment* (E-19), which apply to both life and P&C insurers. OSFI also began to identify the implications and the related necessary adaptions to its life and P&C insurance capital frameworks, the LICAT and the MCT, in support of a robust implementation of the new accounting standard IFRS 17 *Insurance Contracts*, effective January 2021.

Mortgage Insurance Companies

A new regulatory capital framework for residential mortgage insurance came into effect in January 2017. OSFI has continued to work with industry to refine the framework.

Other Guidance

Mortgage Underwriting Practices and Procedures (B-20)

Following consultations, OSFI issued a final guideline in October 2017 that required lenders to enhance their underwriting standards to ensure borrowers can withstand fluctuations in their borrowing costs over time (a stress test), apply greater conservatism in loan-to-value (LTV) measurement and restrict lending arrangements designed to circumvent the LTV limits.

Corporate Governance

OSFI undertook a fundamental review of its corporate governance expectations with a view to making it more principles-based and outcomes-based as well

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as providing clearer delineation of board and senior management responsibilities. OSFI also reviewed all of its guidance that contained expectations of boards to consolidate expectations within its *Corporate Governance Guideline*. The draft revised guideline was issued for comment in November 2017 and a final version will be issued in 2018.

Enterprise-wide Model Risk Management (E-23)

OSFI issued the final version of Guideline E-23, which establishes expectations for institutions in managing and controlling the use of models, whether for regulatory capital determination, internal risk management, valuation/pricing, business decision making or stress testing purposes. The guideline strengthens principles of proportionality by distinguishing expectations between between institutions using internal capital models and those using the standardized approach.

Pillar 3 Disclosure Requirements

OSFI issued a guideline outlining its expectations for implementation of revised Pillar 3 disclosure requirements that come into effect for D-SIBs for the reporting period ending October 31, 2018. Small- and medium-sized banks are expected to continue with existing Pillar 3 disclosure practices. Pillar 3 disclosures provide the public with useful information on regulatory capital and risk exposures of banks, which increase transparency and public confidence in the Canadian financial system.

Total Loss-Absorbing Capacity (TLAC) Disclosure Requirements

OSFI issued two draft guidelines setting out expectations on the implementation of the TLAC disclosure requirements. OSFI expects D-SIBs to implement the TLAC disclosure templates starting with fiscal Q1 2019 reporting. Although disclosures are to start for Q1 2019, D-SIBs will have until November 1, 2021 to fully meet the minimum requirements. The removal of previous transitional guidance applies to all federally regulated deposit-taking institutions.

IFRS 17 – Insurance Contracts

The International Accounting Standards Board (IASB) issued the final version of International Financial Reporting Standard 17 *Insurance Contracts* (IFRS 17) in May 2017. In April 2018, OSFI issued the final Advisory *IFRS 17 Transition and Progress Reporting Requirements for Federally Regulated Insurers*. The Advisory outlines OSFI's expectations regarding early adoption of IFRS 17, accounting for financial guarantee contracts, and semi-annual progress reporting and requirements for submission to OSFI.

Life Insurance Capital Adequacy Test (LICAT) Public Disclosure Requirements

In March 2018, OSFI issued a final LICAT guideline, which included enhancements to disclosures that support transparency of the new regulatory capital requirements. OSFI expects insurers to implement the disclosure requirements starting with fiscal Q4 2018 reporting.

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INTERNATIONAL ACTIVITIES

International organizations play a key role in the development of regulatory frameworks for banks and insurers. OSFI is an active participant in a number of these groups, including the Financial Stability Board, the Basel Committee on Banking Supervision and the International Association of Insurance Supervisors.

Financial Stability Board (FSB)

The FSB was established in April 2009 to coordinate the work of national financial authorities and international standard-setting bodies. It develops and promotes the implementation of effective regulatory, supervisory and other financial sector policies.

Canadian representation on the FSB is shared among the Department of Finance, the Bank of Canada and OSFI. During 2017-2018, OSFI's role included membership on the FSB Plenary, Steering Committee, and Standing Committee on Supervisory and Regulatory Cooperation.

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Some of the work during 2017-2018 included:

- Issuing a report on the financial stability implications from fintech
- Releasing a framework (July 2017) to guide post-implementation evaluations of the effects of G20 reforms
- Publishing a toolkit for firms and supervisors on the use of governance frameworks to mitigate misconduct risk
- Working to finalize implementation of G20 financial sector reforms, including resolution regimes and over-the-counter derivatives.

Basel Committee on Banking Supervision (BCBS)

OSFI is an active member of the BCBS, which provides a forum for international rule-making and cooperation on banking supervisory matters.

In December 2017, OSFI welcomed the finalization of the Basel III reforms that consist of a set of measures to increase risk sensitivity and reduce excessive variability in the calculation of minimum capital requirements across banks and across jurisdictions. OSFI has committed to public consultation on the proposed implementation in order to ensure the capital regime continues to contribute to the safety and soundness of Canadian banks while remaining consistent with our principles for regulation and supervision.

In January 2018, OSFI announced the replacement of the existing capital floor, which places a minimum on the required regulatory capital for a bank using internal models, with a more risk-sensitive capital floor based on the Basel II framework as an interim step until implementation of the Basel III capital floor begins.

International Accounting and Auditing Standards

As all federally regulated financial institutions in Canada are required to follow International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA), OSFI interprets and assesses international rules that may apply to Canadian financial institutions.

In 2017-2018, OSFI worked through the Basel Committee on Banking Supervision and the

International Association of Insurance Supervisors (IAIS) to provide comments to the International Auditing and Assurance Standards Board on its Exposure Draft on ISA 540 (Revised) *Auditing Accounting Estimates and Related Disclosures*.

In February 2018, OSFI provided a comment letter to The Monitoring Group in response to its consultation paper on *Strengthening the Governance and Oversight of the International Audit-Related Standard-setting Boards in the Public Interest*. OSFI also participated in the IAIS' comment letter response to The Monitoring Group consultation paper.

Active participation in the development of these standards and governance frameworks promotes a set of high-quality global standards and enhances our understanding of changes to accounting and auditing standards that may impact FRFIs and OSFI's supervisory approach.

International Association of Insurance Supervisors

OSFI participates in the work of the International Association of Insurance Supervisors (IAIS). The IAIS objectives are to contribute to the improved supervision of the insurance industry for the protection of policyholders worldwide, promote the development of well-regulated insurance markets, and contribute to global financial stability. OSFI is a member of the IAIS Executive Committee, the Policy Development Committee, the Task Force Committee, the Supervisory Forum and several working groups.

OSFI actively participates in the Capital Solvency and Field Testing Working Group and its many work streams that are tasked with developing the Insurance Capital Standard (ICS). In May 2017, as part of its multi-year field-testing exercise, the IAIS issued ICS Version 1.0 for extended field testing. ICS 2.0 was planned to be released for consultation in late summer 2018. OSFI also participated on the IAIS Accounting and Auditing Working Group, which monitors key developments in, among other things, IFRS 17 *Insurance Contracts.*

APPROVALS AND PRECEDENTS

The *Bank Act*, *Trust and Loan Companies Act*, *Insurance Companies Act* and *Cooperative Credit Associations Act* require federally regulated financial institutions to seek regulatory approval from the Superintendent or the Minister of Finance (after receiving the recommendation of the Superintendent) prior to engaging in certain transactions or business undertakings.

Regulatory approvals are also required by persons wishing to incorporate an institution, and by foreign banks or foreign insurance companies wishing to establish a presence or to make certain investments in Canada. OSFI administers a regulatory approval process that is prudentially effective, responsive and transparent. OSFI's Approvals and Precedents Division is responsible for making recommendations to the Superintendent, and to the Minister of Finance for matters requiring regulatory approval.

In 2017-2018, OSFI processed 165 applications, of which 157 were approved and eight were withdrawn. Individual applications often contain multiple approval requests. The 157 approved applications involved 249 individual approvals, 190 of which were granted by the Superintendent and 59 by the Minister. The number of applications decreased from the previous year, when 178 applications were approved.

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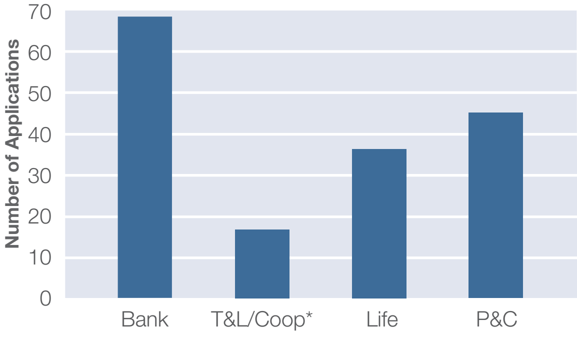
The majority of approved applications for 2017-2018 related to banks (44%) and P&C insurers (29%). (*See figure 1*)

FIGURE 1

Approved Applications by Industry 2017-2018



*Trust and Loan/Cooperative Associations

The most common applications received from deposit-taking institutions related to purchases or redemptions of shares or debentures, substantial investments, changes in ownership, and transfers of assets in excess of 10 percent. Applications received from insurance companies related mainly to substantial investments, changes in ownership, purchases or redemptions of shares or debentures, and related party asset transactions.

During 2017-2018, orders authorizing the establishment of a foreign bank branch in Canada were issued to Mega International Commercial Bank Co., Ltd. and Silicon Valley Bank, and an order to insure in Canada risks was issued to the United States Liability Insurance Company, establishing it as a foreign insurance branch in Canada.

Upon request, OSFI also provides advance capital confirmations on the eligibility of proposed capital instruments. A total of 29 such opinions and validations were provided in 2017-2018, compared to 23 the previous year.

OSFI has performance standards establishing time frames for processing applications for regulatory approval and for other services, all of which were met during the year. More information on service performance standards can be found on OSFI's website.

Guidance and Education

In keeping with the objective of enhancing the transparency of OSFI's legislative approval process and promoting a better understanding of our interpretation of the federal financial institution statutes, OSFI develops and publishes legislative guidance, including advisories, rulings, and transaction instructions. In 2017-2018, OSFI issued an advisory regarding the restrictions on the use of "bank words" and a ruling regarding the "acting jointly or in concert" provisions. OSFI also issued revised transaction instructions regarding exits, amalgamations, sales of all or substantially all assets by deposit-taking institutions, issuance of shares for property, and investments and activities of foreign banks.

Federally Regulated Private Pension Plans

OSFI supervises federally regulated private pension plans and protects pension plan members and other beneficiaries by developing guidance on risk management and mitigation, assessing whether private pension plans are meeting their funding requirements and managing risks effectively, and intervening promptly when corrective actions need to be taken. OSFI holds pension plan administrators ultimately responsible for sound and prudent management of their plans.

Approximately seven percent of private pension plans in Canada are federally regulated (Statistics Canada data as at January 2017). As at March 31, 2018, 1,214 private pension plans were registered under the *Pension Benefits Standards Act, 1985*, covering more than 1,132,000 active members and other beneficiaries in federally regulated areas of employment such as banking, inter-provincial transportation and telecommunications. Between April 1, 2017, and March 31, 2018, federally regulated private pension plan assets increased by 6.4 percent to a value of approximately $219.1 billion *(see figure 2)*.

Private Pension Plan Environment

The overall solvency position of federally registered pension plans improved in 2017. This reflects the positive impact on plan assets of strong returns on equities, while variation in interest rates have had relatively little impact on plan liabilities.

Federal solvency funding requirements are based on a plan's three-year average solvency position, meaning the 2017 overall solvency ratio will replace the generally weaker 2014 value in calculating the three-year average. As a result, most plans are expected to see

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FIGURE 2
Federally Regulated Private Pension Plans by type as at March 31 (last 4 years)[1]

	2015	2016	2017	2018
Total Plans[2]	**1,226**	**1,233**	**1,230**	**1,214**
Defined Benefit	317	306	294	283
Combination	118	124	126	121
Defined Contribution	791	803	810	810
Total Active Membership	**631,300**	**630,700**	**624,400**	**623,400**
Defined Benefit	283,500	250,600	244,100	240,700
Combination	219,800	249,400	250,500	249,300
Defined Contribution	128,000	130,700	129,800	133,400
Total Other Beneficiaries	**444,500**	**478,600**	**494,600**	**508,600**
Defined Benefit	232,800	237,600	246,500	259,200
Combination	195,100	223,900	230,000	230,100
Defined Contribution	16,600	17,100	18,100	19,300
Total Assets ($ millions)	**188,925**	**198,299**	**205,907[3]**	**219,115[3]**
Defined Benefit	99,261	99,150	101,678	108,845
Combination	83,393	92,352	97,131	102,582
Defined Contribution	6,271	6,797	7,098	7,688
Pooled Registered Pension Plans (PRPP)	5	4	4	5
Total Membership	0	25	53	111
PRPP Total Assets	0	16,900	77,300	150,100

[1] Some defined benefit and combination plans were reclassified in 2016. Figures for prior years are restated for comparison purposes.
[2] Not including Pooled Registered Pension Plans.
[3] See figure 4 for a breakdown of assets.

a decrease in their required solvency funding payments for 2018 compared to 2017; however, some plans may experience differences in their funding requirements based on their specific situation.

The volatility of equity markets, which remained abnormally low in 2017, increased to its long-term average in early 2018. Plan sponsors and administrators continue to explore ways to manage volatility and pension risks. These include adjusting investment strategies (dynamic asset allocation, interest in alternative investments and increased leverage), purchasing annuities, closing existing defined benefit plans to new members or terminating these plans, which is expected to continue.

Pooled Registered Pension Plans (PRPPs)

Under the federal *Pooled Registered Pension Plan Act* (PRPP Act) and its regulations, OSFI is responsible for licensing PRPP administrators, registering PRPPs and supervising these plans. At the end of 2017, there were five federally registered PRPPs (one new federal PRPP was registered in 2017), with one reporting that it had entered into contracts with six employers and had enrolled 111 members (the total value of investments was $150,100).

Effective November 15, 2017, *Manitoba joined the Multilateral Agreement Respecting Pooled Registered Pension Plans and Voluntary Retirement Savings Plans*

(PRPP Agreement). The PRPP Agreement effectively delegates to OSFI responsibility for licensing, registering and supervising PRPPs whose operations fall within the jurisdiction of both the federal government and the participating provinces. In addition to Manitoba, the participating provinces are British Columbia, Nova Scotia, Ontario, Quebec[1] and Saskatchewan.

Risk Assessment, Supervision and Intervention

OSFI's Risk Assessment System for Pensions (RASP) analyzes information from pension plan filings, submitted via the Regulatory Reporting System (RRS) and other sources. OSFI regularly upgrades these systems to make them more efficient. In 2017-2018, OSFI reviewed certain risk assessment tools and procedures used during the supervisory process to strengthen our risk-based approach to supervision. OSFI streamlined its review of actuarial reports and developed new approaches to analyzing information from pension plan regulatory filings.

OSFI also collected and analyzed information and followed trends regarding pension plans with DC provisions to consider potential future supervisory changes.

Solvency Testing

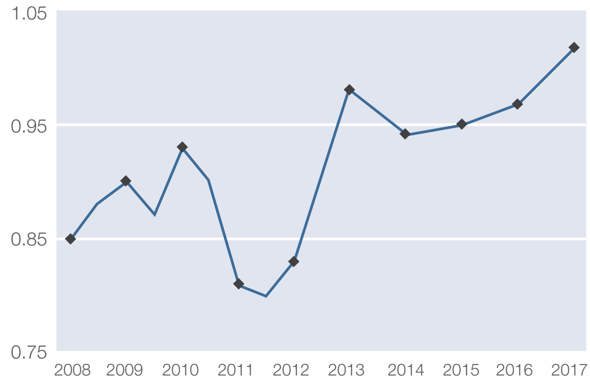
OSFI regularly estimates the solvency ratio (the ratio of assets over liabilities on a plan termination basis) for about 370 plans with defined benefit provisions. The Estimated Solvency Ratio (ESR) results help identify any solvency issues that could affect the security of members' promised pension benefits before a plan files its actuarial report. The ESR results also help identify broader trends.

The weighted average ESR for all pension plans was 1.02 as at December 31, 2017, up from 0.97 at the end of 2016 (*see figure 3*). The most recent ESR results indicated that 63 percent of defined benefit plans were underfunded as at December 31, 2017, down from 80 percent at the end of 2016. Also, there has been a decrease in the number of plans that are more significantly underfunded (ESRs below 0.80) from 16 percent at the end of 2016 to 13 percent at the end of 2017.

FIGURE 3

Defined Benefit Plans' Estimated Solvency Ratio (ESR) Distribution (past 10 years)

Estimated Solvency Ratio (ESR)



For more information on the ESR results, please refer to the May 2018 issue of *InfoPensions* on OSFI's website

Actuarial Report Reviews

Actuarial reports submitted to OSFI are reviewed for compliance with our expectations. Issues raised as part of these reviews provide an opportunity for actuaries to discuss OSFI concerns with actuarial reports, which may have an impact on current and future funding requirements. OSFI intervention in 2017-2018 resulted in some plans being required to amend and re-submit their actuarial reports.

Examinations

As part of its risk-based supervisory approach, OSFI conducts examinations of select plans. During 2017-2018, OSFI performed nine examinations: two examinations were of defined benefit plans; three were of defined contribution plans; and four were of combination plans (plan having both defined benefit and defined contribution provisions). The examinations may be limited to a desk review or could be conducted on the plan administrator's premises.

Watch List

Pension plans facing higher risk – due to their financial condition, plan management or other reasons

[1] The PRPP Agreement does not give OSFI responsibility with respect to the Quebec Voluntary Retirement Savings Plan (VRSP), but permits authorized VRSP administrators to act as PRPP administrators under the federal PRPP Act if they register a PRPP federally.

– are placed on a watch list and actively monitored. At March 31, 2018, 37 plans were on the watch list (an increase from 30 plans at March 31, 2017). Of the 37 plans, 24 were defined benefit plans and 13 were defined contribution plans. During 2017-2018, 13 new plans were added to the watch list while six plans were removed.

Rules and Guidance

Regulations amending the Pension Benefits Standards Regulations, 1985 and the Pooled Registered Pension Plans Regulations

These regulations came into force on June 23, 2017, and included a change to the maximum allowable amount of letters of credit that an employer may use to reduce solvency special payments under the Pension Benefits Standards Regulations, 1985 (PBSR). The regulations changed the maximum cumulative limit from 15 percent of market value of plan assets to 15 percent of solvency liabilities, resulting in an increased limit for plans using letters of credit. The change also harmonized the limit with that of other jurisdictions that permit the use of letters of credit. Similar changes were made to increase the maximum permitted reduction in solvency payments for agent Crown corporations.

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Minor changes were also made to the provisions respecting the locked-in vehicles to which a plan member may transfer their pension benefits under the PBSR and the Pooled Registered Pension Plans Regulations. The changes were mostly technical, with most clarifying existing provisions.

Pension Industry Outreach

In October 2017, OSFI held a pension industry forum in Toronto. The forum provided an opportunity for plan administrators and other pension stakeholders, including advisors, service providers and representatives of federal pension plan members and retirees to hear from OSFI about current issues. Topics included updates on pension policy developments, OSFI's supervision of pension plans, approvals and actuarial issues, and recent pension litigation related to federally registered pension plans.

In November 2017, OSFI conducted a survey of plan administrators and professional advisors to obtain their assessment of OSFI's effectiveness as a supervisor and regulator. These consultations are a part of our ongoing commitment to be responsive to stakeholder input and to seek suggestions for improvement. Survey results are published on our website.

Guidance

A revised version of the *Guide to Intervention for Federally Regulated Private Pension Plans* was published in March 2018, primarily to clarify the degree of supervisory actions or interventions that plan administrators can expect OSFI to take in different circumstances.

A guideline for *Derivatives Sound Practices for Federally Regulated Private Pension Plans* was released in February 2018. It outlines the factors that OSFI expects plan administrators to consider when developing policies and procedures for the sound risk management of derivative activities. A draft guideline was published for public comment in July 2017 and comments received were incorporated into the February 2018 version.

Guidance notes on eligible default investment options were published for pooled registered pension plans in July 2017 and for defined contribution plans in March 2018. The guidance notes set out OSFI's interpretation and expectations related to the requirements for the investment option selected by the plan administrator as the default investment option.

Revisions were also made to existing guidance material. The *Frequently Asked Questions* on OSFI's website were updated and revised in November 2017. An updated *Instruction Guide for the Preparation of Actuarial Reports for Defined Benefit Pension Plans* was posted in October 2017. A revised guide for Asset Transfers related to *Defined Benefit Provisions of Pension Plans* and a revised guidance note for *Asset Transfers related to Defined Contribution Provisions of Pension Plans*, along with accompanying forms, were released in March 2018. Revisions were also made to various guides and forms related to the annual filing requirements.

InfoPensions

OSFI published its biannual pension newsletter, *InfoPensions*, in May and November 2017. The newsletter includes announcements and reminders on issues relevant to plan administrators, pension advisors and other stakeholders. It also includes descriptions of how OSFI applies select provisions of the pension legislation and guidance.

Approvals

Federally regulated private pension plans are required to seek approval from the Superintendent for several types of transactions. These include plan registrations and terminations, asset transfers between registered defined benefit pension plans, refunds of surplus, and reductions of accrued benefits. The number of pension transactions submitted to the Superintendent for approval decreased to 37 in 2017-2018 from 64 in 2016-2017. OSFI processed 54 applications for approval in 2017-2018, compared to 64 applications in 2016-2017.

In 2017-2018, 14 new plans were registered by OSFI (six defined benefit, seven defined contribution and one pooled registered pension plan), while 17 plan termination reports were approved (five defined benefit and 12 defined contribution plans). In 2016-17, 29 new plans were registered by OSFI (10 defined benefit and 19 defined contribution plans), while 14 plan termination reports were approved (11 defined benefit and three defined contribution plans).

FIGURE 4

Asset Breakdown of Private Pension Plans Regulated by OSFI

	2016		2017	
Asset Class	$ Millions	%	$ Millions	%
Debt Securities and Cash	93,716	45.6	103,058	47.0
Equity	84,462	41.0	87,538	40.0
Diversified Investments	9,774	4.7	10,615	4.9
Other Investments	25,823	12.5	27,016	12.3
Accounts Receivables net of Liabilities	(7,868)	-3.8	(9,112)	-4.2
TOTAL NET ASSETS	**205,907**	**100.0**	**219,115**	**100.0**

Investment return net of investment and custodial fees was 9.7% in 2017, compared to 6.5% in 2016.

Office of the Chief Actuary

The Office of the Chief Actuary (OCA) contributes to a financially sound and sustainable Canadian public retirement income system by providing expert actuarial valuation and advice to the Government of Canada and to provincial governments that are Canada Pension Plan (CPP) stakeholders.

The OCA provides statutory actuarial valuation and advisory services for the CPP, Old Age Security (OAS) program, the Canada Student Loans Program (CSLP) and the Employment Insurance program, as well as pension and benefits plans covering the federal public service, the Canadian Forces, the Royal Canadian Mounted Police, federally appointed judges and members of Parliament.

The OCA was established within OSFI as an independent unit. The fact that it is hosted by OSFI ensures its independence and impartiality are beyond question. The Chief Actuary reports to the Superintendent; however, the accountability framework of the OCA makes it clear that its staff is solely responsible for actuarial advice provided.

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Office of the Chief Actuary

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Tabling of the *14th Actuarial Report on the Old Age Security program*

The OCA is required by law to produce an actuarial report on the OAS program every three years or whenever an amendment is made to the program that affects the cost of benefits. The triennial *14th Actuarial Report on the OAS program as at 31 December 2015* was tabled on August 16, 2017. It provides information on the OAS program's future expenditures until 2060. The report facilitates a better understanding of the status of the program and the factors that influence its costs, contributing to an informed public discussion.

The Old Age Security program, financed from Government of Canada general tax revenues, is one of the cornerstones of Canada's retirement income system. Benefits include the basic Old Age Security pension, the Guaranteed Income Supplement and the Allowance. The basic Old Age Security pension is a monthly benefit available to most Canadians who meet age and residence requirements. The age of eligibility for OAS benefits is 65. The Guaranteed Income Supplement and the Allowance are monthly benefits paid to residents of Canada who receive a basic, full or partial Old Age Security pension and who have little or no other income.

In 2017, about six million Canadians received OAS benefits, with a total value of approximately $50 billion or 2.5 percent of the gross domestic product (GDP). The key findings show that over the long term, the ratio of total OAS expenditures to GDP is projected to reach a high of 3.2 percent by 2031 and then slowly decrease to a level of 2.8 percent by 2050.

External Peer Review of the *27th CPP Actuarial Report*

The OCA is constantly looking for better ways to work, and to be more responsive to client needs. Innovations are put in place whenever possible and the OCA is continually working to strengthen its technical expertise as well as internal and external communications. The external peer reviews of CPP actuarial reports and their ensuing recommendations have helped the OCA achieve these objectives and ensure that it continues to provide a valuable service with tangible benefits to Canadians.

In April 2017, the OCA released the findings of an independent peer review panel commissioned to review the *27th Actuarial Report on the CPP*. Key findings were reported in the *2016-2017 OSFI Annual Report* and the complete review report is available on the OSFI website under Office of the Chief Actuary.

The peer review panel complimented the Chief Actuary and the OCA staff on their competence, commitment and professionalism. The peer review resulted in 11 recommendations dealing with various aspects of the report, including data, methodology, communication of results and other actuarial issues.

The OCA has either taken action or plans to take action on these recommendations. In particular, the OCA will continue to broaden its sources of information before setting assumptions. The work performed by the Chief Actuary and other members of the OCA as chairs and vice-chairs of the International Social Security Association Commission on Statistical, Actuarial and Financial Studies, of the Social Security Committee and the Population Issues Working Group of the International Actuarial Association, as well as the planned OCA inter-disciplinary seminar in September 2018, were aimed at gathering opinions from national and international experts. The OCA will also continue to obtain expert advice in such fields as demographics, economics, statistics and investments.

To further increase the transparency and independence of the peer review process, an external party was responsible for the oversight of the review. The U.K. Government Actuary's Department (GAD) selected the peer review panel members and released an opinion in April 2017 noting that the peer reviewers adequately covered all the main issues. (The GAD opinion is also available on the OSFI website.)

Public Sector Insurance and Pension Plans

In 2017-2018, the OCA completed four actuarial reports on public sector insurance and pension plans, which were submitted to the President of the Treasury Board for tabling before Parliament. The *Actuarial Report on the Pension Plan for the Federally Appointed Judges as at 31 March 2016* and the *Actuarial Report on the Pension Plan for the Members of Parliament as at 31 March 2016* were tabled on November 3, 2017. The *Actuarial Report on the Regular Force Death Benefit Account as at 31 March 2016* and the *Actuarial Report on Pension Plans for the Canadian Forces – Regular Force and Reserve Force as at 31 March 2016* were tabled on November 7 and 8, 2017, respectively.

These reports provide actuarial information to decision makers, parliamentarians and the public, thereby increasing transparency and confidence in Canada's retirement income system.

Actuarial Report on the Employment Insurance Premium Rate

In 2017-2018, the OCA presented to the Canada Employment Insurance Commission the *2018 Actuarial Report on the Employment Insurance Premium Rate*, which was tabled in Parliament on September 27, 2017. The report provided the forecast break-even premium rate for the upcoming year and a detailed analysis.

Special Events, Presentations and Special Studies

In 2017-2018, the OCA released *Actuarial Study No.18: Canada Pension Plan Adjustment Factors*. The report specified the CPP actuarial adjustment factors for pre- and post-65 retirement pension take-up in the *27th CPP Actuarial Report*. Actuarial Study No. 18 described the methodology used to calculate these factors and provided the unrounded estimates. The study confirmed that the CPP legislated actuarial adjustment factors are appropriate.

The impacts of increasing longevity on the sustainability of pension plans attract attention both in Canada and around the world. The OCA published the *OAS Mortality Fact Sheet*, which noted that while for both male and female OAS beneficiaries, life expectancy has continually increased between 2000 and 2016, there is a decreasing trend in the annual mortality improvement rates for all age groups under age 80. In 2017-2018, the Chief Actuary and staff continued to discuss topics of longevity at national and international events and participated in the work of professional actuarial groups dealing with this matter.

In 2017-2018, the Chief Actuary and OCA staff discussed extensively, both in Canada and abroad, the design of the CPP enhancement as well as actuarial estimates presented in the *28th CPP Actuarial Report*.

For a complete list of studies, meetings, presentations and speeches, see the Office of the Chief Actuary section of OSFI's website.

Corporate Services

Communicating Effectively

OSFI communicated its plans and activities to a wide range of stakeholders via its website and other means. As in previous years, OSFI received many requests for speakers to address external conferences and events. The Superintendent and senior officials delivered a number of presentations and remarks across Canada and internationally.

OSFI's external newsletter, *The Pillar*, was published four times in 2017-2018. It updates stakeholders on the latest guidelines, notices, public statements and other pertinent information.

Throughout the year, OSFI communicated with interested Canadians, including industry, regulators, the news media, parliamentarians and the general public:

- Hosted 3,115,718 website visits
- Responded to 7,069 public enquiries, 107 inquiries from members of Parliament and 221 inquiries from news media
- Delivered 27 presentations to industry and regulatory forums, including eight key speeches that were posted on the website
- Processed 35 access to information requests and 52 consultations within permitted statutory timelines, as per the *Access to Information Act*
- Appeared at five parliamentary committee hearings
- As part of its routine surveys and consultations, sought feedback from the property and casualty insurance sector and private pension plans.

Information Management and Technology

OSFI's IM/IT achievements in 2017-2018 included completion of a multi-year project to deliver a new electronic document and records management system (EDRMS). The new system ensures information is better managed and used more effectively and has led to greater efficiency. A project to automate and support supervisory activities moved into the procurement phase. Enhancements were made to OSFI's privacy and information management program.

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As well, OSFI upgraded to the latest Microsoft operating system and OfficeSuite to provide a modern and secure computing platform. OSFI's cyber security posture was strengthened through the implementation of a new cyber security policy, which advances best practices in cyber risk mitigation and guides further maturation of our cyber security controls.

Human Resources

Given OSFI's knowledge-based environment, it depends on the expertise of its staff to meet its mandate and maintain its position as a world-class financial regulator. At March 31, 2018, OSFI had just over 750 employees in offices located in Ottawa, Montréal, Toronto and Vancouver. OSFI employees have a wide range of skills, including financial services experience, regulatory expertise, risk management and a variety of corporate services backgrounds.

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Human Capital Strategy

To achieve its strategic outcomes, OSFI's priority is to have a high-performing and effective workforce and in support of this, launched its Human Capital Strategy in May 2017. It includes five key priorities: leadership development, talent management, learning and development, culture and community building, and enterprise change management.

Over the course of the 2017-2018 fiscal year, the organization focused on building programs and activities that will lay the foundation for its future under each of the five key priorities. The accomplishments include:

- Design of a unique leadership development program to supplement strong technical expertise
- Implementation of a talent management program for senior leaders to ensure that they are supported in reaching their potential and to support the mandate
- Application of a 360º feedback tool to develop key leadership competencies
- Development of an enterprise-wide change management framework, methodology, tools, operational model and training
- Development and implementation of a core learning program for supervisory staff, with an increase in courses designed and delivered and the development of new e-learning material
- Training on coaching skills for people managers
- Development of an outline of a new recognition program to acknowledge employee contributions in support of accomplishing work
- Launch of annual employee surveys (from biannual) to capture the pulse of the organization more frequently
- Implementation of activities to celebrate OSFI's 30th anniversary and legacy
- Implementation of clear guiding principles to support a more flexible work environment

Many of these activities will move from development to implementation as OSFI continues to invest in its future.

In addition to the work being done in developing OSFI's workforce, investments were also made in OSFI's facilities in Toronto, Ottawa, Montréal and Vancouver. From updating accessibility features for easier office access to refreshing OSFI's common spaces to allow for increased collaboration and interaction, we will continue to provide OSFI employees with the environment they need to succeed in their everyday work.