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The OSFI Pillar

FROM THE OFFICE OF THE SUPERINTENDENT OF FINANCIAL INSTITUTIONS

A Canadian perspective on the global insurance industry

The following is an excerpt from remarks by Superintendent Julie Dickson to the 47th Annual Seminar of the International Insurance Society in Toronto, Ontario, on June 21, 2011.

The global financial system remains fragile and the world is still a very uncertain place. In Europe, there is still much uncertainty in how to deal with sovereign debt issues and fiscal problems in the U.S. are impossible to ignore. In addition, the increased frequency of natural disasters has raised concerns among industry participants and regulators. What is particularly troubling is that these disasters increase insurance risk in many forms (mortality, morbidity, property, liability, and business interruption) and this increase will shift the costs and practices in the insurance industry in unknown directions.

As you know, Canada weathered the financial crisis relatively well. While we were pleased that Canada's financial institutions did come through this period relatively unscathed, it is important that Canadian institutions and regulators not become complacent. We believe that the financial crisis has provided an opportunity for reflection and to apply the lessons learned. These lessons are relevant for Global insurers even if the epicentre of the crisis was the banking industry.

These lessons include:

- The need for insurance companies to continually improve risk management and governance, and not assume that the absence of problems means that controls and oversight must be strong;

(continued on page 2...)

Focus on Corporate Governance

As weaknesses in corporate governance were identified as a contributing factor in the global financial crisis, OSFI is placing even more emphasis on promoting robust risk management practices and effective corporate governance at financial institutions.

To complement its supervision practices and existing corporate governance guidance, OSFI has a dedicated Corporate Governance Unit. A key part of this group's work is to review risk governance practices across banks and life insurance companies, looking at areas such as risk appetite -- how it is defined, measured, monitored, controlled and reported and what incentives are in place related to risk taking.

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Dickson: Canadian Perspective… (cont'd from page 1)

- The need to move to a robust, harmonized insurance capital regime globally;
- The need to move to a converged set of global accounting standards; and,
- The need for much more robust and aligned supervisory practices globally.

Without the above, concerns about global competitiveness, and uncertainties about companies' strength relative to others, will be present, which should not be acceptable to policyholders, investors, supervisors, or the companies themselves.

To view the complete remarks, visit the OSFI website at www.osfi-bsif.gc.ca.

Corporate Governance… (cont'd from page 1)

More recently, a Corporate Governance Advisory Committee was established. Chaired by the Superintendent, the Committee will discuss best practices and serve as a sounding board to gather insight and exchange information. It is comprised of individuals from outside OSFI who offer diversified industry experience.

OSFI's efforts in promoting strong corporate governance will help contribute to Canada's safe and sound financial system.

Actuarial Report: RCMP (dependants) Pension Fund

The Actuarial Report on the Benefit Plan financed through the Royal Canadian Mounted Police (dependants) Pension Fund as at March 31, 2010 was tabled before Parliament on June 13, 2011.

To view the complete report, visit the OSFI website at www.osfi-bsif.gc.ca.

Guideline A-4—Internal Target Capital Ratio for Insurance Companies

On June 17, 2011, OSFI issued a guideline to outline its expectations for federally regulated life insurance companies and federally regulated property and casualty insurance companies with respect to the setting of an internal target capital ratio. Guideline A-4 also addresses the subject of how capital adequacy assessment fits within the context of OSFI's Supervisory Framework.

This Guideline is in force effective immediately, and is addressed to both the Life and P&C industries, domestic companies and branches. OSFI expects that insurance companies will become fully compliant with the Guideline within one year of the date this Guideline is released.

Recent volatile market conditions have put pressure on some financial institutions' capital positions, emphasizing the need for an appropriate and supportable internal target capital ratio.

A draft version of the Guideline was released for comment on May 21, 2010. As a result of comments received from the insurance industry, various changes were made to provide clarification of the terminology used throughout the Guideline, eliminate confusion created by the inclusion of certain examples and clarify other minor issues.

OSFI will conduct a follow-up review of internal target capital ratios after the release of the final Guideline in order to ensure that the Guideline is leading to the establishment of appropriate internal targets. OSFI may issue additional guidance in the future with respect to the process for determining the internal target, the risks an insurer should assess and considerations for quantifying those risks.

To view the complete guideline, visit the OSFI website at www.osfi-bsif.gc.ca.

Whole Loan Sales and ACM Calculation

In April 2011, OSFI issued a Ruling regarding Whole Loan Sales and Asset-to-Capital Multiple (ACM).

The OSFI Advisory *Conversion to International Financial Reporting Standards (IFRSs)* dated March 2010 confirms that accounting rules will continue to provide the basis for the calculation of the ACM for federally regulated deposit-taking institutions (DTIs). The Advisory also states that irrespective of accounting treatment, “the ACM should also reflect the originator’s exposure as a result of the securitization” and where its “balance sheet exposure is not deemed to be materially reduced by the securitization, continued inclusion in the ACM may be appropriate”.

Section III of the Advisory described accounting and regulatory capital implications of IFRSs on derecognition and consolidation. The regulatory capital impact focused on ACM and reiterated that, while the accounting treatment would remain the basis for calculating the asset numerator in the ACM under IFRS, OSFI retained discretion to make an exception in certain circumstances.

OSFI has received certain questions on the application of this exception to different transactions. As a result, it was determined that Capital Rulings, applicable to specific requests and submissions from DTI’s in respect of certain transactions, could be helpful, either individually or collectively, for understanding and applying OSFI’s position. The April 2011 ruling describes the specifics of one such situation and how OSFI concluded with respect to the treatment under the ACM.

To view the complete ruling, visit the OSFI website at www.osfi-bsif.gc.ca.

Guidance Note — DC Asset Transfers

In June 2011, OSFI issued a revised Guidance Note to inform the pension industry of OSFI’s expectations when asset transfers related to defined contribution (DC) provisions of pension plans occur. This includes transfers from plans with members subject to provincial pension legislation.

When assets related to defined contribution provisions of a federally regulated pension plan are being transferred to another pension plan, OSFI expects plan administrators to ensure that affected members’ rights and benefits are preserved. Specifically, prior to transferring assets related to defined contribution provisions, OSFI expects transferring plan administrators to ensure that:

- The value of a member’s defined contribution account balance is not reduced.
- All contributions due are remitted to the transferring plan for the affected members.
- Any outstanding interest or dividend distributions earned to the date of transfer will be deposited to the member’s account in the receiving plan.
- Transferring members are informed of the asset transfer and their account balance.
- The affected members’ records will be transferred to the receiving plan administrator.

This Guidance Note is a result of the *Pension Benefits Standards Act, 1985* (PBSA) being amended to remove the requirement to obtain the Superintendent’s permission to transfer assets related to defined contribution provisions, effective July 12, 2010.

The Guidance Note came into effect immediately and replaces the previous Instruction Guide for DC Asset Transfers issued in August 2010.

To view the complete guidance note, visit the OSFI Web site at: www.osfi-bsif.gc.ca

Internal Capital Adequacy Assessment Process

On June 2, 2011, OSFI issued an updated version of its expectations regarding Internal Capital Adequacy Assessment Process (ICAAP) for Deposit Taking Institutions (DTIs) implementing the Standardized Approach to Credit Risk, to clarify OSFI’s near-term ICCAP expectations.

In December 2009 and September 2008, OSFI wrote to all DTIs implementing the Standardized Approach to Credit Risk (“Standardized DTIs”) to outline its expectations of the Standardized DTIs for Pillar I and Pillar II implementation going forward. OSFI recognizes that the ICAAP will mature based on greater use and experience with Pillar II processes. While the principles governing the ICAAP are not new *per se* to capital management, the level of rigour and transparency expected of the process is new. The ICAAP is an important process and requirement for all DTIs. OSFI believes that a robust ICAAP will help DTIs better manage through business cycles.

To view the complete document, visit the OSFI website at www.osfi-bsif.gc.ca.

OSFI 2011-2012 Report on Plans and Priorities tabled in Parliament

OSFI's 2011–2012 Report on Plans and Priorities highlights several areas where we will focus our efforts. 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.

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. We will be paying particular attention to the effects of 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 market consistent approach.

OSFI's participation and leadership in international fora like the Basel Committee on Banking Supervision, the International Senior Supervisors Group, the Financial Stability Board and the International Association of Insurance Supervisors is an important part of ensuring that Canada maintains a flexible and robust financial framework.

The economic crisis has shown us that problems can quickly spread across many jurisdictions and even those institutions that were well managed and supervised were impacted. It is clear that there is a need for strong international standards and our participation in these fora help to ensure that the Canadian experience can be shared and that Canada can continue to apply global best practices.

It is important that OSFI has the right people and right tools to continue to be effective in the face of transformational rule changes and new risks that may arise. Our plan includes a critical renewal of our information management and technological infrastructure and a renewed focus on forward-looking Human Resources strategies particularly in very specialized areas of financial institution operations so as to continue to identify and assess risks at very early stages.

To view the complete report, visit the OSFI website at www.osfi-bsif.gc.ca.

What's New Online (www.osfi-bsif.gc.ca)

MCT/BAAT Audit Requirement

A letter announcing OSFI's decision to postpone implementation of the audit requirement for the MCT/BAAT by one year, to fiscal years beginning on or after January 1, 2012, has been posted on our website.

Remarks by Superintendent Julie Dickson

Remarks to the 2011 Property and Casualty Insurance Industry Forum, Cambridge, Ontario, June 1, 2011, have been posted to our website.

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

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The OSFI *Pillar*

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