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The OSFI Pillar

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

FSB mortgage principles; Canadian expectations

On November 2, 2011, OSFI issued a letter to federally regulated financial institutions, to make them aware of the recently published Financial Stability Board (FSB) principles for mortgage underwriting, and to outline supplemental elements to the FSB's October 26, 2011 consultation document.

The current FSB document is materially aligned with OSFI's expectations for residential mortgage underwriting, although the consultative period could yield some amendments. Once finalized, federally regulated financial institutions in Canada should deem these international principles as minimum criteria, and should consider them

in the context of their own current mortgage lending practices.

Given the current uncertainty and volatility in global capital markets, historically low interest rates, higher Canadian borrower debt-to-income levels, and relatively strong housing price appreciation, OSFI expects federally regulated financial institutions to be extra diligent in maintaining sound and prudent mortgage underwriting practices.

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

Draft Instruction Guide for reduced pension benefits

On January 4, 2012, OSFI issued a Draft Instruction Guide to inform the pension industry of the factors, as well as the specific requirements OSFI generally considers with respect to an application seeking the Superintendent's authorization under paragraph 10.1(2)(a) of the *Pension Benefits Standards Act, 1985* (PBSA). This paragraph is in respect of an amendment that reduces pension benefits or pension benefit credits accrued before the date of the amendment or an immediate or deferred pension benefit to which a member or former member was entitled before the date of the amendment.

The factors and requirements set out in the Draft Instruction Guide are intended to ensure the protection of members', former members' and other beneficiaries' rights and

interests under the PBSA and to ensure the minimum funding requirements for the ongoing pension plan will be met.

This Draft Instruction Guide is intended for plan administrators of defined benefit pension plans registered under the PBSA. It may be used while in draft form and replaces the Instruction Guide for the Authorization of Amendment Reducing Benefits in Defined Benefit Pension Plan issued in April 2006. OSFI would appreciate receiving comments on the Draft Instruction Guide by no later than February 15, 2012.

To view the complete Draft Instruction Guide, as well as an Authorization Request Form, visit the OSFI website at www.osfi-bsif.gc.ca.

Superintendent speaks to life insurance forum

On November 7, 2011, Superintendent Julie Dickson spoke to the 2011 Life Insurance Invitational Forum in Cambridge, Ontario. The following is an excerpt from that speech:

What is particularly troubling is that the volatility in today's financial markets is accompanied by a slowing down of the economy. Various monetary policy responses have lowered interest rates, especially long-term rates. Should rates continue at the current low level – below 3% on government bonds for a 30-year term – it will be a real game changer for the life insurance sector.

Since life insurers often lock in their assumptions for the expected rate of return when the product is priced, there is an implicit assumption that the life insurer will continue to earn the same average interest rate over the lifetime of the product. When interest rates fall life insurers must reinvest the renewal premiums on new investments at lower rates than originally priced, leading to a compression in the product margin. This, in turn, can sometimes lead to the development of other strategies to increase profits, but

which can create other risks.

It is encouraging that many life insurers are re-examining their product strategies and avoiding issuing new products with unsustainable long-term guarantees. Ironically, we may be seeing a return to traditional product offerings, such as participating whole life with guarantees based on very low interest rates and conservative mortality, lapse, and expense assumptions supported by dividend scales, which are adjusted based on the investment and insurance experience of the par fund.

As regulators, we want life insurers to maintain healthy solvency ratios and still deliver on their promises to policyholders. If insurers are moving risk from their balance sheets onto policyholders, policyholders need to understand the risks they are assuming – we would not want to see a repeat of the vanishing premium events of the early 1990s.

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

OSFI statement on early adoption of IFRSs

OSFI has concluded that federally regulated entities should not early adopt the following new or amended International Financial Reporting Standards (IFRSs):

- Consolidation and related standards
 - IFRS 10 Consolidated Financial Statements
 - IFRS 11 Joint Arrangements
 - IFRS 12 Disclosure of Interests in Other Entities
 - IAS 27 Separate Financial Statements
 - IAS 28 Investments in Associates and Joint Ventures
- IFRS 13 Fair Value Measurement
- Amendment to IAS 19 Employee Benefits
- Amendment to IAS 1 Presentation of Items of Other Comprehensive Income

These are among the new or amended IFRSs issued by the International Accounting Standards Board in May and June that may affect federally regulated entities. Given the considerable work effort in transitioning to IFRS and amount of recently issued IFRSs with a similar effective date, OSFI believes that adhering to the mandatory effective dates as stated in each of the respective IFRSs provides a reasonable timeframe for federally regulated entities to adequately plan, analyze and implement these accounting standards within their organization. On October 31, 2011, OSFI issued a letter about this subject to all federally regulated entities.

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

Ruling regarding foreign credit card activities

OSFI has concluded that the undertaking of certain activities in Canada in support of a foreign bank's credit card program would not cause the related foreign bank to be deemed as carrying on business in Canada for the purposes of Part XII of the *Bank Act*.

The services of a card issuer in respect of the foreign bank, including the provision of accounts by the card issuer, as

well as the foreign bank's occasional customer support visits would merely be more efficient ways for the foreign bank to fulfill obligations that it undertook from outside Canada. None of these would constitute separate profit-making activities for the foreign bank.

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

P&C MCT Advisory Committee vision paper

In December 2011, the Property & Casualty Minimum Capital Test Advisory Committee released its final vision, or structural outline, for new principles-based solvency financial requirements for Canadian property and casualty insurers to regulators and the industry in a paper entitled *Canadian Vision for Property and Casualty Insurer Solvency Assessment*.

The paper calls for regulatory asset requirements to be calculated on two bases – a Target Asset Requirement and at a minimum level, the Minimum Asset Requirement.

The Committee is co-chaired by representatives of the industry and a representative of OSFI. Its members are senior representatives from the Insurance Bureau of Canada, the Canadian Institute of Actuaries, the Property and Casualty Insurance Compensation Corporation, the Autorité des marchés financiers, OSFI and the Canadian Council of Insurance Regulators, as well as representatives from insurance and reinsurance industries.

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

Revisions to Capital Adequacy Requirements

On December 21, 2011, OSFI announced that chapters 6 and 8 of Capital Adequacy Requirements (CAR) Guideline A-1 and chapter 5 of Guideline A have been revised to reflect changes set out in the Basel Committee on Banking Supervision (BCBS) guidance, *Enhancements to the Basel II framework*, *Guideline for computing capital for incremental risk in the trading book*, and *Revisions to the Basel II market risk framework updated as of December 31 2010*.

The revised CAR Guidelines A-1 and A were originally released in 2010 reflecting the guidance of the BCBS contained in the comprehensive document *International Convergence of Capital Measurements and Capital Standards* (Basel II), and updated to incorporate certain changes primarily related to the implementation of International Financial Reporting Standards in Canada.

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

Participating Account Management disclosure guideline

On November 14, 2011, OSFI released the final version of Guideline E-16: Participating Account Management and Disclosure to Participating Policyholders and Adjustable Policyholders.

A number of provisions in the *Insurance Companies Act* with respect to participating policies and adjustable policies were recently brought into force. In addition, the *Policyholders Disclosure Regulations*, which support the Act on the subject of participating and adjustable policies,

was brought into force on June 1, 2011.

Guideline E-16, which applies to Canadian life insurance companies, addresses the new requirements for participating and adjustable policies by providing direction to companies on how best to comply with the revised requirements.

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

Actuarial reports for Canadian Forces pension plans

On October 25, 2011, a pair of actuarial reports for pension plans for the Canadian Forces prepared by the Office of the Chief Actuary of Canada were tabled in the House of Commons. One was for the pension plan for the regular force, and the other was for the pension plan for the reserve force. Both reports are for the plans' status as at March 31, 2010.

The regular force plan is defined by Parts I, III and IV of

the *Canadian Forces Superannuation Act*, the *Pension Benefits Division Act* and the Canadian Forces-related benefits provided under the *Special Retirement Arrangements Act*. The reserve force plan is defined by Part I.1 of the *Canadian Forces Superannuation Act* and the *Pension Benefits Division Act*.

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

Superintendent appears before Senate Standing Committee on Banking, Trade and Commerce

Superintendent Julie Dickson was before the Senate Standing Committee on Banking, Trade and Commerce on November 23, 2011 to speak about the present state of the domestic and international financial system. The following is an excerpt from the Superintendent's opening remarks:

Canada has benefited from well-capitalized and generally well-managed financial institutions. But neither regulators like OSFI nor the institutions themselves can become complacent.

The global economy remains fragile and financial markets are volatile. In recent months, the global financial environment has deteriorated and projections for economic growth in many countries have

been revised down. A mild recession is now projected in Europe and the U.S. recovery is very weak. The European debt crisis creates additional risks and uncertainty.

Such developments obviously affect financial institutions. Lower growth will have a negative impact on profits. Institutions are already dealing with extremely low interest rates that affect margins and assumptions about future returns. In terms of the European debt crisis, while the total direct exposure of the Canadian banking sector to the most vulnerable countries is small, if Europe does not address its problems, all countries will be affected and the impacts are difficult to predict.

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

Senior Director also before committee

On December 8, 2011, Patty Evanoff, Senior Director, Legislation and Approvals Division, was also before the Standing Committee on Banking, Trade and Commerce, to speak about Bill S-5, An Act to amend the law governing financial institutions and to provide for related and consequential matters. The following is an excerpt from Ms. Evanoff's opening remarks:

A key element in OSFI's mandate is to "advance and administer a regulatory

framework that promotes the adoption of policies and procedures designed to control and manage risk." To fulfill this mandate we look forward to the five-year statutory legislative review process, but we also regularly refine our own guidance to ensure that we have an effective regulatory framework that is sensitive to developing risks, and promotes industry best practices.

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

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

- Actuarial Report (10th) supplementing the Actuarial Report on the Old Age Security Program as at 31 December 2009
- Revised 'Commonly Asked Questions' document related to the Minimum Continuing Capital and Surplus Requirements Standardized Approach Quantitative Impact Study No. 3
- Updated: Questions and Answers – Guidance for Reinsurance Security Agreements
- Internal Audit Report on Enterprise Risk Management

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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