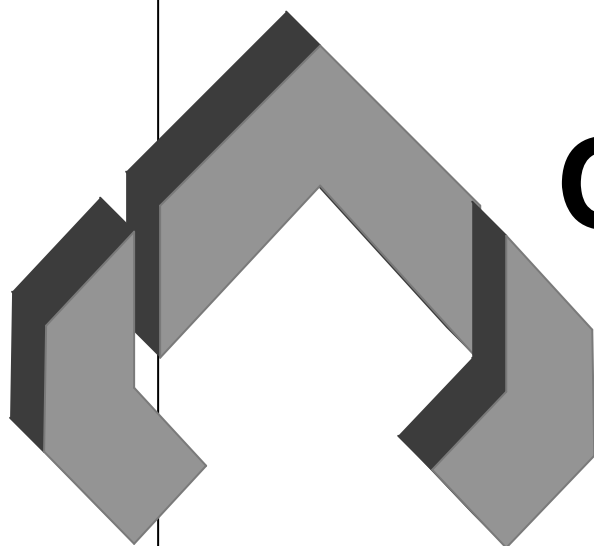




**Office of the Superintendent
of Financial Institutions**

**Bureau du surintendant
des institutions financières**



OSFI Supervisory Model

**IAIS-ASSAL Regional Seminar
2003**

Unclassified





Agenda

- ❑ Achieving OSFI's Mission
- ❑ Key Supervisory Framework Principles
- ❑ Development of Rating
- ❑ Sharing of Supervisory Ratings
 - Composite risk rating
 - Oversight function ratings
- ❑ OSFI intervention activity
- ❑ Implications for financial institutions



OSFI's Mission

To safeguard policyholders, depositors, and pension plan members from undue loss.

This is achieved by advancing and administering a regulatory framework that contributes to public confidence in the financial services industry. At the same time, OSFI ensures the regulatory system does not preclude institutions from competing effectively



International Assistance

- ❑ International Advisory Group provides hands-on technical advice, training workshops and seminars, primarily to supervisors in the areas of bank and insurance company regulation and supervision.



Background

- ❑ 130 Deposit Taking FIs
- ❑ 350 Life and Non-Life insurers
- ❑ 1200 Pension Plans

- ❑ 400 Employees



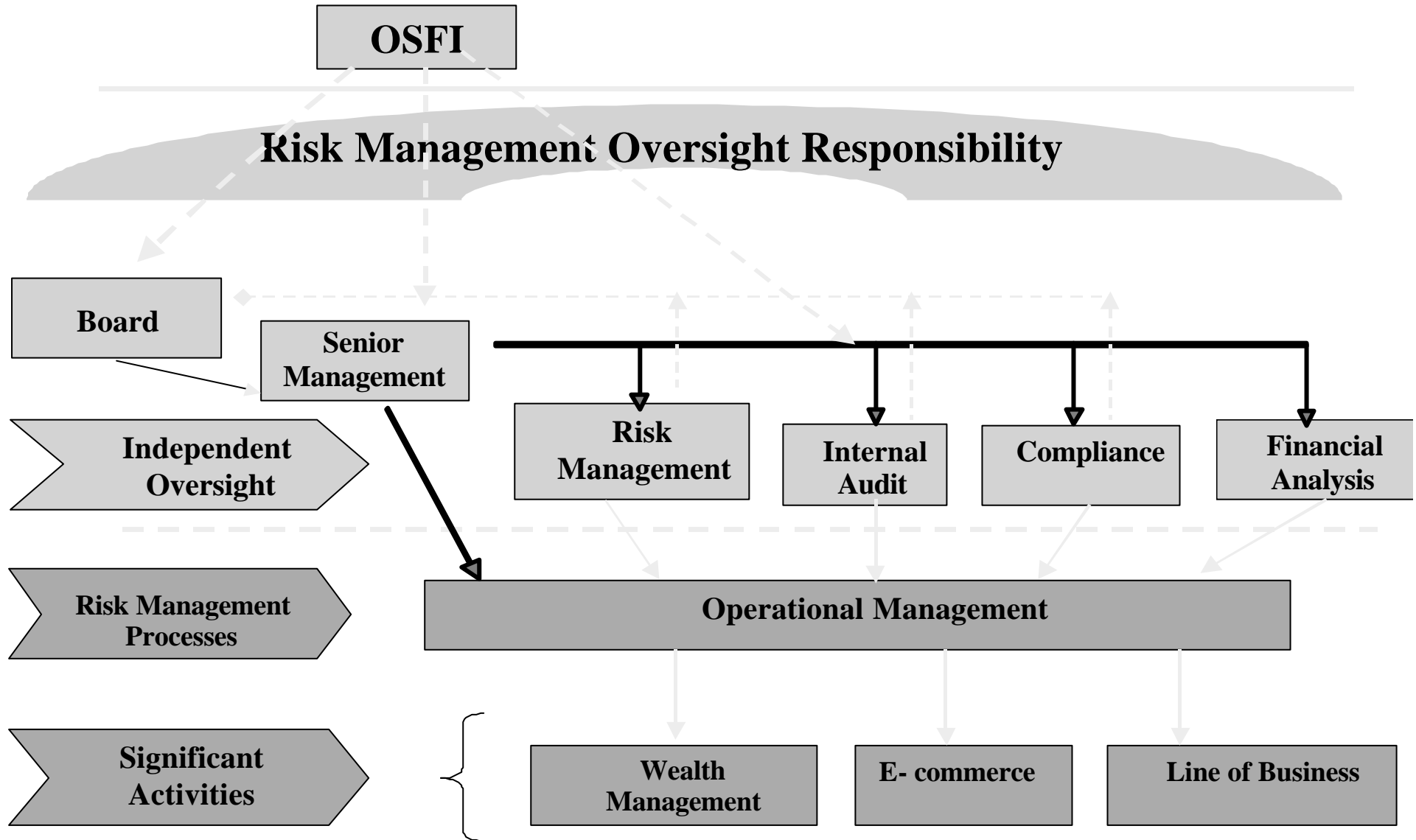
Safeguard from Undue Loss

Identify institution-specific risks and trends, and intervene in a timely manner to minimize losses to policyholders, depositors, and pension plan members



Some Key Framework Principles

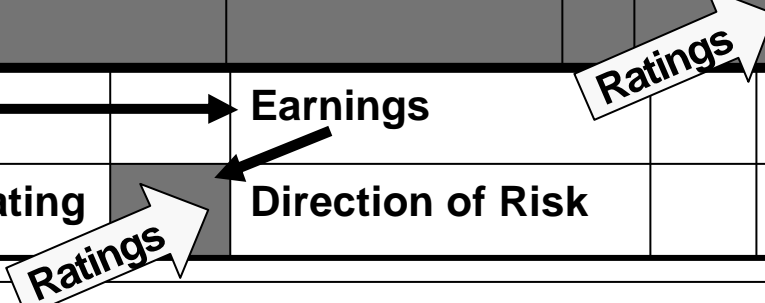
- Applies to all FI's
- Supervise on a consolidated basis
- Exercise sound judgment
- Level of scrutiny based on risk assessment
- Leverage off work of major oversight functions
- Reliance on auditors and appointed actuary





Risk Matrix

Financial Institution Risk Matrix as at...					
Significant Activities	Materiality	Inherent Risks	Quality of Risk Management	Net Risk	Direction of Risk
Activity 1		• Credit	Operational Management	• Operational Management	
Activity 2		• Market		• Financial Analysis	
Activity 3		• Liquidity		• Compliance	
Etc.		• Insurance		• Internal Audit	
		• Operational	• Risk Management		
		• Legal & Regulatory	• Senior Management		
		• Strategic	• Board Oversight		
Overall Rating					
Capital		Earnings			
Composite Rating		Direction of Risk		Time Frame	





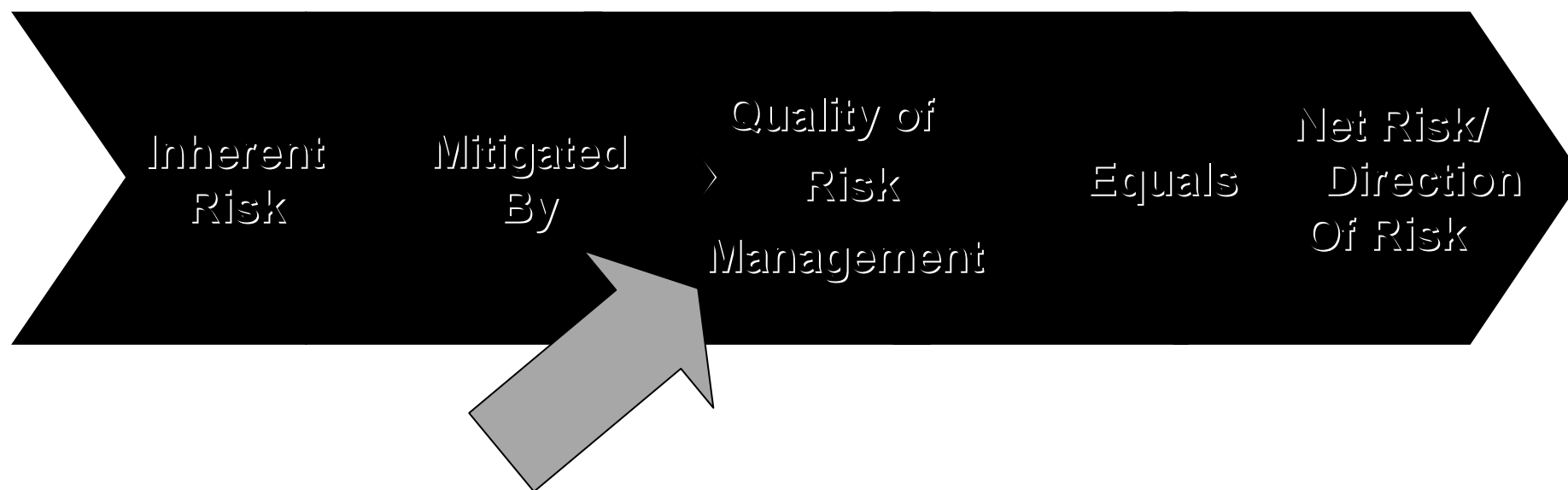
Significant Activities

□ Examples

- Major lines of business – corporate lending, group life, commercial liability
- Enterprise-wide activity – asset and liability management, strategic planning, reinsurance



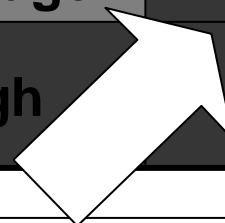
Risk Equation for a Significant Activity





Risk Assessment Matrix

Net Risk	Level of Inherent Risk for Significant Activity			
Aggregate Quality of Risk Management for Significant Activity	Low	Moderate	Above Average	High
Strong	Low	Low	Moderate	Moderate
Acceptable	Low	Moderate	Above Average	Above Average
Needs Improvement	Moderate	Above Average	High	High
Weak	Above Average	High	High	High





Completed Risk Matrix

Financial Institution Risk Matrix as at...											
Significant Activities	Materiality	Inherent Risks				Quality of Risk Management				Net Risk	Direction of Risk
		Cr	Mk	Ins	Op	OM	IA	SM	Bd		
Pers Lines – 50+	40%	L		L	L	S	NI	S	A	L	Incr
Investments	60%	M	M			A	NI	S	A	M	Stable
Claims Admin.	H				M	A	NI	S	W	M	Incr
Overall Rating							NI	S	NI	M	Incr

Capital	W	Earnings	W	
Composite Rating	AA	Direction of Risk	I	Time Frame
				1Yr



Assessment Criteria

Composite Risk

- Overall Net Risk
- Earnings
- Capital
- Composite Risk

Oversight Functions

- Board of Directors
- Sr. Management
- Risk Management
- Internal Audit
- Compliance
- Financial Analysis



Development of Criteria Industry Consultation

□ Industry Associations

- Canadian Bankers Association
- Canadian Fraternal Association
- Canadian Life & Health Insurance Association
- Credit Union Centrals
- Insurance Bureau of Canada
- Trust Companies Association



Sharing of Ratings

- ❑ Began sharing Composite Risk Ratings in 2002
- ❑ Full implementation over three years
- ❑ Ratings will be tied to coverage
- ❑ Confidentiality protected by Regulation
- ❑ Peer comparison over time

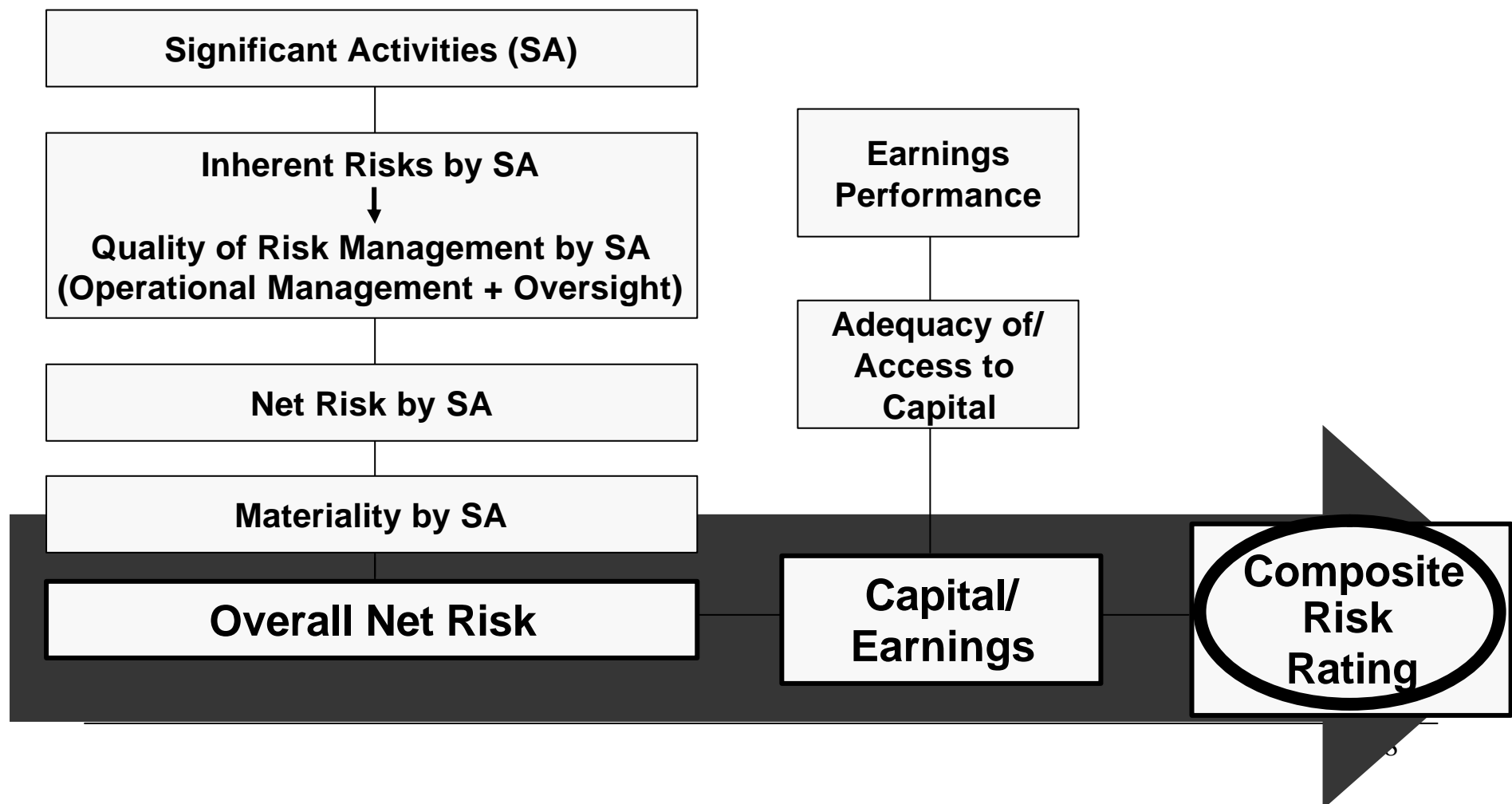


Confidentiality of Ratings

Supervisory Information Regulations prohibit institutions from disclosing, directly or indirectly, prescribed supervisory information, including the ratings, except as specifically permitted by the regulations. Institutions are permitted to disclose the ratings to affiliates, directors, officers, employees, auditors, actuaries, securities underwriters or legal advisors, provided they ensure the continued confidentiality of the information



Composite Risk





Composite Risk

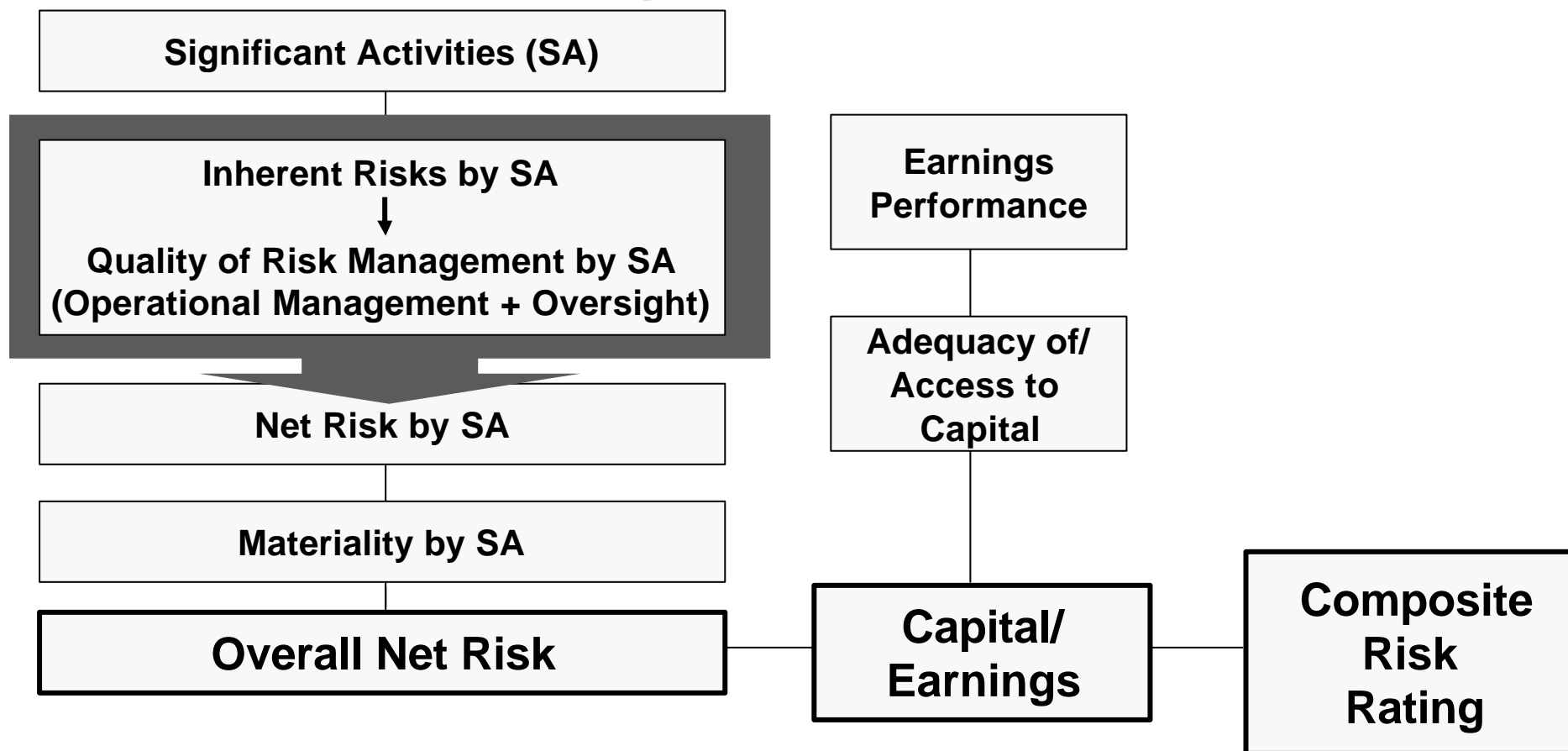
□ Definition

➤ **Low Composite Risk**

A strong, well-managed institution. The combination of its overall net risk and its capital and earnings makes the institution resilient to most adverse business and economic conditions without materially affecting its risk profile. Its performance has been consistently good, with most key indicators in excess of industry norms, allowing it ready access to additional capital. Any supervisory concerns have a minor effect on its risk profile and can be addressed in a routine manner.



Oversight Functions





Sharing of Ratings Oversight Functions

- Essential Elements
- Criteria
- Performance Indicators



- Strong
- Acceptable
- Needs Improvement
- Weak

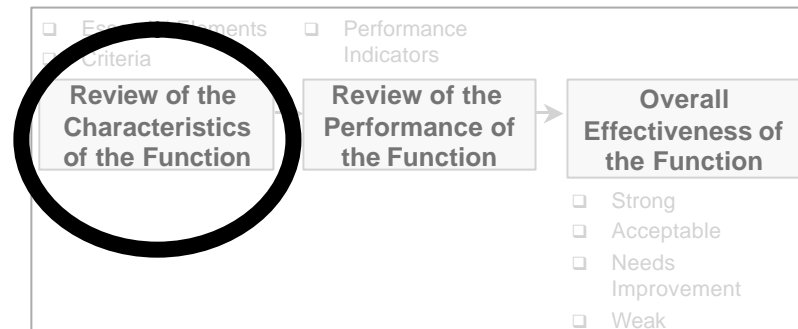


Oversight Functions

□ Function Characteristics

➤ Essential Elements

- Key features of a function based on its mandate
- Can be objectively observed and assessed





Oversight Functions

- Examples of Essential Elements
 - Mandate
 - Organization Structure
 - Resources
 - Methodology and Practices
 - Senior Management and Board Oversight



Oversight Functions

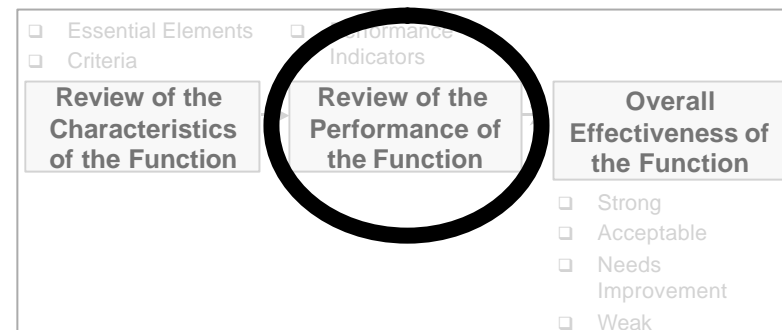
- ❑ Examples of Board Criteria
 - Composition
 - ❑ Appropriateness of the unaffiliated representation on the Board (1.6)
 - Practices
 - ❑ Adequacy of policies and practices to promote independent, effective, and timely decision making, including practices related to the role of unaffiliated directors (4.2)



Oversight Functions

Effective Performance

- Demonstrated effectiveness of oversight in the context of the function's mandate
- Evaluated based on performance indicators (e.g., proactive follow-up of issues identified to ensure timely resolution)

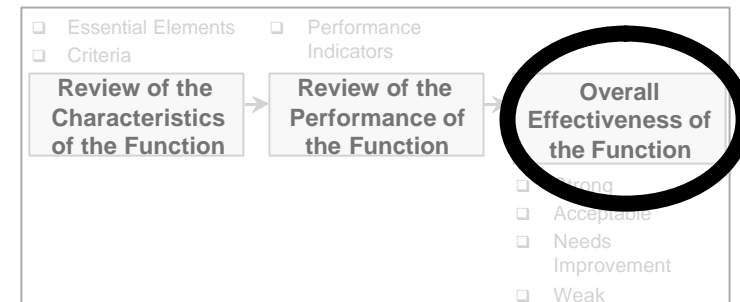




Oversight Functions

□ Overall Rating

- Rating of the effectiveness of the oversight across all Significant Activities
- Judgment based on an evaluation of the characteristics and performance of the function in relation to the nature, scope, complexity and risk profile of the institution





Board Oversight

□ Weak Board Oversight

- The composition, role and responsibilities, and practices of the Board are not, in a material way, what is considered necessary, given the nature, scope, complexity and risk profile of the institution. Board performance has demonstrated serious instances where effectiveness needs to be improved through immediate action. Board characteristics and/or performance often do not meet generally accepted corporate governance practices.



CRR and Intervention

While OSFI may stage an institution for reasons other than its CRR, there is a link between the Composite Risk Rating and OSFI's stages of intervention

<input type="checkbox"/> Low	0	No Concerns
<input type="checkbox"/> Moderate	0 1	Early Warning
<input type="checkbox"/> Above Average	1 2	Risk to Solvency
<input type="checkbox"/> High	2 3 4	Risk to Solvency Viability Doubtful Insolvency Imminent



Fulfilling OSFI's Mission

- Risk-based assessments
- Leverage off work of oversight functions
- Focus on higher net risk activities
- Share assessments with institution
- Intervention commensurate with CRR



Implications for FRFIs

The Framework and criteria are internal tools used by OSFI to assess supervised institutions. Sharing these tools will increase the transparency of OSFI's assessments and help institutions better understand the basis of the assessments and the significance of assigned ratings