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June 28, 2000

To: Members of the Executive Board

From: The Acting Secretary

Subject: **Canada—Report on the Observance of Standards and Codes**

The attached report on the observance of standards and codes for Canada on the financial sector has been prepared by reformatting and editing Volume II of the Canada—Financial System Stability Assessment Report (FO/DIS/00/2, Sup. 1, 1/4/00), which was discussed at EBM/00/11 on February 2, 2000.

In the absence of an objection by a Director by noon on Friday, June 30, 2000, this report will be published on the Fund's external website.

Mr. Johnston (ext. 38980) and Mr. Huang (ext. 36132) are available to answer technical or factual questions relating to this paper.

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# CANADA

## Report on the Observance of Standards and Codes (ROSC)

Prepared by:  
Staff of the International Monetary Fund

# Canada

## Banking Supervision

Prepared by a staff team from the International Monetary Fund, in the context of the Financial Sector Assessment Program (FSAP), on the basis of self-assessments provided by the Canadian authorities

International Monetary Fund  
June 2000

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## **CANADA: OBSERVANCE OF THE BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION<sup>1</sup>**

1. This report provides an assessment of Canada's observance of and consistency with relevant international standards and core principles in the financial sector, as part of a broader assessment of the stability of the financial system. This assessment work by the IMF was undertaken under the auspices of the IMF-World Bank Financial Sector Assessment Program (FSAP) based on information up to October 1999. This has helped to place the standards assessments in a broader institutional and macroprudential context, and identify the extent to which the supervisory and regulatory framework has been adequate to address the potential risks in the financial system. The assessment has also provided a source of good practices in financial regulation and supervision in various areas.

2. The assessment covered (i) the Basel Core Principles for Effective Banking Supervision; (ii) the International Organization of Securities Commissions' (IOSCO) Objectives and Principles of Securities Regulation; (iii) the International Association of Insurance Supervisors' (IAIS) Supervisory Principles; (iv) the Committee on Payment and Settlement Systems' (CPSS) Core Principles for Systemically Important Payment Systems; and (v) the IMF's Code of Good Practices on Transparency in Monetary and Financial Policies. Such a comprehensive coverage of standards was needed as part of the financial system stability assessment for Canada in view of the increasing convergence in the activities of banking, insurance, and securities firms, and the integrated nature of the markets in which they operate. It should be noted that some of the standards are still in draft form, and some do not yet have a complete methodology to systematically assess compliance or consistency.<sup>2</sup> This module was prepared in consultation with the Canadian authorities in the context of the IMF FSAP mission that visited Canada in October 1999, and constitutes a summary report of the detailed assessments prepared by the mission.

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<sup>1</sup> The work of the mission was coordinated by an FSAP team led by Mr. V. Sundararajan (IMF). Messrs. Alvir Hoffmann (Central Bank of Brazil), Michael Martinson (Board of Governors of the Federal Reserve System), and Stefan Spamer (Deutsche Bundesbank) were the principal contributors to this module.

<sup>2</sup> The Basel Core Principles were issued in September 1997; a Core Principles Methodology was released in October 1999 by the Basel Committee on Banking Supervision. The Code of Good Practices on Transparency was adopted by the Interim Committee in September 1999; work on a supporting document is in progress. The IOSCO Objectives and Principles were issued in September 1998, and a detailed self-assessment methodology is being developed. A draft of the Core Principles for Systemically Important Payment Systems was issued for public comment in December 1999. The IAIS Insurance Supervisory Principles were issued in September 1997; a self-assessment program has been developed to assist member countries in evaluating compliance.

3. The assessment of standards and codes draws on the self-assessments of the Canadian authorities, and on field work of the undertaken October 11-22, 1999, based on a peer review process by Kai Barvell (Payment Systems, Sveriges Riksbank), Karl Driessen and Charles Siegman (Transparency Code, IMF), Alvir Hoffmann (Banking Supervision, Banco Central do Brasil), Rodney Lester (Insurance, World Bank), Michael Martinson (Banking Supervision, Board of Governors of the Federal Reserve System), Stefan Spamer (Banking Supervision, Deutsche Bundesbank), and Shane Tregillis (Securities, Australian Securities and Investments Commission). The expert team was coordinated by the IMF FSAP mission, led by V. Sundararajan, and comprised R. Barry Johnston, Karl Driessen, Haizhou Huang and Martin Cerisola. The assessment has been communicated to the authorities.

4. Overall, the assessment found a high degree of compliance that had contributed to a stable financial system. Minor deviations from Basel Core Principles of Effective Supervision were detected, which are addressed by proposals contained in the Policy paper.<sup>3</sup> Full compliance with the Core Principles for Systemically Important Payment Systems was noted for the Large Value Transfer System. Canada is broadly compliant with all principles of insurance regulation, and is broadly consistent with IOSCO Objectives and Principles of Securities Regulation. The complexity of federal/provincial regulatory arrangements, oversight of mutual funds, and resource limitations on the enforcement capacity of some securities commissions are areas of concern that are being addressed. There is a high degree of consistency with the Code of Good Practices on Transparency in Monetary and Financial Policies. The more specific findings in the area of banking supervision are discussed below.

#### **A. Background and Overview**

5. Canada has a highly developed, well diversified, and sound financial system which plays an important role in the economy. Assets held by the Canadian financial sector represented the equivalent of about 250 percent of GDP in 1997, with chartered banks accounting for roughly 60 percent of total assets. The banking sector has been largely dominated by six widely held domestic banks, with closely held foreign banks playing a relatively minor role; the "Big Six" chartered banks represent about 90 percent of banks' assets and deposits. The responsibility of the federal government in banking is explicitly set out in the constitution. Thus, all banks and federally chartered trust and loan companies fall under the jurisdiction of the Office of the Superintendent of Financial Institutions (OSFI).

6. The banking system has a strong capital position, with capital adequacy ratios above Basel minimums, and is adequately provisioned against impaired loans. Profitability of the domestic banks is good, with a return on equity of around 15 percent for the six large banks, although profitability of foreign banks has been weak. The large domestic banks have increasingly absorbed other financial institutions—the trust companies and securities dealers.

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<sup>3</sup> Department of Finance, Canada (1999), "Reforming Canada's Financial Services Sector: A Framework for the Future," June 25.

Banks' off balance sheet and derivative transactions have grown rapidly and banks have become much more reliant for their income on capital market activities. Banks' overseas exposures have also grown rapidly and they have strategically refocused on the U.S. market thus making them more dependent on the outlook for the U.S. economy. The major banks that are most active in off balance sheet and derivative transactions have upgraded their risk-management systems.

7. In the banking sector, there is virtual full compliance with the Basel Core Principles of Effective Banking Supervision. The overall assessment is that there is full compliance with 23 core principles and partial compliance with 2 core principles (see Table 1 for a tabular summary). Some minor shortcomings were noted with regard to the following principles:

- Core Principle 14: The supervisor does not have the legal authority to require changes in the composition of a bank's board and management. The Superintendent does not have the explicit legal authority to remove board members.
- Core Principle 22: Legislation does not currently provide authority to bar the appointment of an individual from banking once the person has been hired.

8. Full compliance for Core Principle 14 and 22 will be achieved after the implementation of the proposals contained in the Policy paper. According to those proposals, the Superintendent of Financial Institutions will have additional supervisory powers to deal with the potential for increased risk in the system, including granting the Superintendent the power to remove directors and senior officers from office in certain circumstances, such as in instances of misconduct, and additional powers to deal with related party transactions of financial institutions.

9. To the extent that nonbank deposit-taking institutions are supervised by OSFI, the same evaluation of the Core Principles of Effective Banking Supervision as provided above applies. However, no systematic assessment of compliance with these principles of provincial regulators—who oversee deposit-taking institutions with a combined market share of about 10 percent—exists, and information and resources were not available to perform such an assessment. However, limits on lending concentration and lending to related parties seem to be observed.

Table 1. Canada: Compliance with the Basel Core Principles

CP	Principle	FC <sup>1/</sup>	BC <sup>2/</sup>	NC <sup>3/</sup>	Mat NC <sup>4/</sup>	Comments and Corrective Actions
1.1	Clear Supervisory Responsibilities	X				See CP 3.
1.2	Independence and Resources	X				
1.3	Legal Framework	X				
1.4	Supervisory Powers	X				
1.5	Legal Protection	X				
1.6	Information Sharing	X				Extensive arrangements for sharing information exist. Nevertheless, questions remain on the effectiveness of ongoing exchange of information with provincial securities regulators.
2	Permissible Activities	X				
3	Licensing of Banks	X				Licensing is currently the prerogative of the Minister of Finance, however, in practice this is usually on the recommendation of OSFI.
4	Transfer of Ownership	X				
5	Acquisitions and Investments	X				
6	Capital Requirements	X				
7	Loan Policies	X				
8	Loan Classification	X				OSFI guidelines exist on impaired loans, and additional guidance is provided by CDIC Standards. Although OSFI expects banks to have in place a mechanism to continually assess strength of collateral and worth of guarantees, this expectation is not explicitly documented.
9	Management Information on Risk Concentration	X				OSFI guidelines ensure that policies are followed on large exposure. However, there is no requirement to identify exposure of 10% of capital and more as large exposure.
10	Connected Lending	X				While related party transactions are not subject to Board approval, the Board is required to review the bank's practices and procedures
11	Country Risks	X				
12	Market Risks	X				
13	Other Material Risks	X				
14	Internal Controls		X			Internal controls are monitored through OSFI's Supervisory Framework and CDIC's Standards. However, the Supervisor has no legal authority to remove Board members, or to require changes in the composition of Board or Management. This should be rectified with the Policy paper proposals.
15	Money Laundering	X				
16	On-site/Off-site Supervision	X				
17	Understanding Banks' Operations	X				OSFI expects continuous disclosure by banks on significant developments. However, banks are not required by law to give notification of any substantive changes in activities or of any adverse developments.
18	Prudential Reporting	X				
19	Independent Examination of Prudential Information	X				OSFI uses on-site examinations and external auditors to validate supervisory information. However, there exists no guideline to assess the quality of work done by external auditors for supervisory purposes



20	Consolidated Supervision	X				
21	Accounting and Disclosure	X				Banks are required to use Canadian GAAP, which are considered consistent with international accounting standards. However, banks are not required to apply international accounting standards directly.
22	Corrective Action		X			Although the Supervisor has a wide array of sanctions at his disposal, he does not have the authority to bar an individual from banking once the person has been hired. This should be rectified with the Policy paper proposals.
23	Global Supervision	X				
24	Cooperation with Foreign Supervisors	X				
25	Foreign Banks' Branches Total	X				

1/ FC: Fully compliant

2/ BC: Broadly compliant

3/ NC: Non-compliant

4/ Mat. NC: Materially non-compliant

## B. Assessment of Core Principles

### Core Principle 1

#### Responsibilities, objectives, operational independence, resources, legal framework for powers, protection for supervisors, information sharing

10. The banking system is regulated by a tripartite structure, the Office of the Superintendent of Financial Institutions (OSFI), which is the only agency responsible for supervising banks in Canada, the Canada Deposit Insurance Corporation (CDIC), and the Department of Finance—in charge of developing the policy and legislative framework for the financial sector. The Bank Act provides a comprehensive legislative framework for banking and requires a review of the act every five years. The OSFI Act mandates the responsibilities and objectives of OSFI. The CDIC Act sets forth the responsibilities and objectives of CDIC.

11. The Bank Act requires banks to provide the Superintendent with such information, at such times and in such form as the Superintendent may require. The Bank Act provides legislated authority for OSFI to address compliance with laws and with safety and soundness of banks. OSFI has a number of means at its disposal to intervene, if needed, in the activities of a financial institution. The Bank Act provides specific criminal sanctions for non-compliance with the legislation. As part of an upcoming legislative package, OSFI is seeking authority to levy civil monetary penalties for breeches of legislation and supervisory agreements. The legislation gives each agency operational independence (the superintendent is appointed for seven years and OSFI is primarily financed by the industry it regulates). However, the Minister of Finance has some formal powers to overrule OSFI on chartering and some banking policy issues.

12. **Assessment:** There is compliance with Core Principle 1. However, there is some uncertainty about the involvement of the Department of Finance in licensing (see CP 3), and the effectiveness of the ongoing exchange of information, coordination and responsibilities between OSFI, CDIC and the provincial securities supervision authorities.

### **Core Principles 2-5**

#### **Licensing, Ownership**

13. An effective supervisory framework exists governing the use of the term “bank”, the licensing process, ownership control and acquisitions and investments. The use of the term bank is restricted and the permissible activities of banks and the permissible investment powers are clearly defined by the Bank Act. Only licensed and supervised institutions are permitted to take “proper bank deposits” from the public. The licensing authority is the Minister of Finance, not the Superintendent. The Bank Act authorizes the Minister of Finance to issue letters patent incorporating a bank. OSFI is the sole authority responsible for recommending the issuance of letters patent. In the case of foreign banks, OSFI requires consent from the home country supervisor. In Canada “significant” ownership is clearly defined in Schedule I bank ownership rules. Any change in the ownership/control of Schedule II banks requires the Minister's approval. Canadian supervision authorities have the authority to establish criteria for reviewing major acquisitions or investments by a bank and for ensuring that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.

14. **Assessment:** The Canadian authorities comply with these principles. The Minister of Finance's involvement makes the licensing process more complicated. However, in practice the Minister of Finance apparently does not override OSFI recommendations based on safety and soundness grounds.

### **Core Principles 6-15**

#### **Prudential regulations and requirements**

15. Canadian banks are required to comply with the capital adequacy requirements established in the Basel Accord. In a letter dated January 28, 1999, the Superintendent set minimum target for risk-based capital ratios of 7 percent for Tier 1 capital and 10 percent for total capital. All banks complied at the end of June 1999.

16. OSFI employs a risk-based methodology to evaluate an institution's risk profile, financial condition, risk management processes and compliance with applicable laws and regulations. In addition, institutions are required to perform annually a self-assessment of their adherence to the CDIC Standards of Sound Business and Financial Practices.

17. With respect to concentrations in the portfolio and limits to restrict bank exposures to single borrowers or groups, OSFI requires credit limits to single or connected borrowers of 25 percent of regulatory capital. There are also requirements for information systems in place to identify the concentrations. An institution's practices with respect to large loan exposures

would be reviewed in the context of the institution's risk profile. OSFI's Prudent Person Approach requires institutions to manage concentration of risks in investment and loan portfolios. CDIC's Standard of Sound Business and Financial Practices on Credit Risk Management provides additional guidance to institutions on best practices associated with the management of credit risk.

18. OSFI requires that for the validation of banks' Value-at-Risk (VAR) models for reporting market risk capital, such models accurately measure, monitor and adequately control market risks (see above). OSFI requires that banks have comprehensive and robust scenario and stress testing programs and contingency plans, and that they perform such tests at least once a month (most Canadian banks do this weekly, while some banks do them even daily).

19. OSFI requires that banks have internal controls in place that are adequate for the nature and scale of their business. Sound internal control practices are also addressed in CDIC's Standards which require risk identification, evaluation and management systems to assist in prudential management of a bank's operations. Internal control policies and procedures need to be approved by the Board of Directors, and their effectiveness assessed by an independent internal audit/inspection function, on an annual basis.

20. *OSFI's Supervisory Framework* requires that the quality of risk management be evaluated for each significant activity in which the bank is engaged. Board oversight and senior management are identified as two critical management control functions and are assessed in order to arrive at an overall evaluation of the quality of risk management. Liquidity risk, interest risk and operational risk are specifically identified as risk categories in OSFI's Supervisory Framework. The Framework requires a dynamic risk assessment process to assess inherent risk. This is based on a thorough understanding of the environment in which the institution operates and its various business activities. In addition, banks in general have liquidity contingency plans in place.

21. OSFI expects banks to have codes of conduct that, among other matters, deal with *ethical behavior towards customers*. The CDIC Standards Assessment and Reporting Program (SARP) also includes an Internal Control Standard that, among other requirements, requires a bank to have a comprehensive code of conduct. Since January 1, 1990, OSFI has included an examination of money laundering detection procedures residing in institutions as part of its examination of deposit-taking institutions.

22. **Assessment:** Partial compliance. Regarding Core Principle 14, the supervisor does not have the legal authority to require changes in the composition of the Board and management. Nor does the Superintendent have the explicit legal authority to remove board members. Full compliance with Core Principle 14 will be achieved after the enactment of the Policy paper proposals. Regarding Core Principle 9 additional criterion 1, there is no requirement to identify exposures of 10 percent or more of bank's capital as a large exposure. Regarding Core Principle 10, while most related party transactions are not subject to approval by the bank's board, the Conduct Review Committee of the board is required to

review the bank's practices and procedures, to ensure that such transactions are proper individually and in the aggregate.

### **Core Principles 16-20**

#### **Supervision approach, ongoing supervision**

23. Consolidated supervision is an essential element of banking supervision in Canada. OSFI reviews the organizational structure as a part of the planning phase of its supervisory activities and in the development of the risk profile of the bank. Where the bank has corporate bodies responsible for activities that are deemed to be of significance in relation to the risk profile of the consolidated group, OSFI will extend its supervisory processes to that corporate body. OSFI's risk-based approach to supervisory activities includes the evaluation of all significant activities of the bank, whether banking-related or non-banking related. This includes domestic and foreign operations, and activities of subsidiaries and affiliated companies of the bank. This also implies that all regulatory filings are to be prepared on a consolidated basis.

24. Consolidated supervision is carried out through a combination of on- and off-site supervision. In the context of off-site supervision, an essential element is that OSFI meets with key officers and management of a bank on a regular basis. A key principle of the supervisory framework is the process of reliance on external auditors, which includes enabling OSFI to review the working papers of external auditors in support of the annual audit of banks' financial statements.

25. **Assessment:** Full compliance. Regarding Core Principle 17, although there exists no legal requirement to notify the supervisor of any substantive changes in activities or any adverse developments, this is done in practice through on-going monitoring and on-site supervision. Regarding Core Principle 19, there does not exist a guideline for the quality of work done by external auditors for supervisory purposes.

### **Core Principle 21**

#### **Information requirements**

26. The Bank Act requires banks to prepare their annual statements in accordance with Canadian Generally Accepted Accounting Principles. Supervisory reports are prepared on a basis consistent with that used for public reporting. Reporting frequency depends on the nature and purpose of the report and will be either monthly or quarterly. The Bank Act further requires banks to be audited in accordance with generally accepted auditing standards. Although the Bank Act does not require Canadian banks to apply international accounting and auditing standards, this objective is being achieved indirectly through CICA's efforts to harmonize accounting standards.

27. **Assessment:** OSFI fully complies with the spirit of Core Principle 21. Improvement in this area could be reached if Canadian banks apply international accounting standards directly.

## **Core Principle 22**

### **Corrective actions**

28. OSFI has extensive powers to safeguard the soundness of the banking system. It clearly participates in deciding when and how to effect the orderly resolution of a problem bank situation. OSFI's mandate and related supervisory powers are focused on early intervention. OSFI has the authority to directly take control of an institution and initiate legislative procedures, but the Minister of Finance has a veto on public interest grounds. Also, the government has documented and publicly disclosed a guide to intervention for federal financial institutions, which provides an outline of the coordinated intervention processes applied by OSFI and CDIC. As part of the Policy paper, it is proposed that OSFI have the authority to also impose civil monetary penalties for violations of legislation or written agreements with banks and other federal financial institutions.

29. **Assessment:** Partial compliance. Legislation does not currently provide authority to bar the appointment of an individual from banking once the person has been hired. Full compliance will be reached after the implementation of the Policy paper proposals.

## **Core Principles 23-25**

### **Cross border supervision**

30. The Bank Act requires a bank to provide access to records of controlled domestic and foreign subsidiaries and authorizes the Superintendent to enter into agreements with foreign regulators in that regard. The Superintendent may also direct any affiliate of the bank to provide information. The Supervisory Framework applies equally to all significant activities of the bank regardless of whether that activity takes place in a foreign branch, joint venture or subsidiary.

31. A key component of consolidated supervision is establishing contact and information exchange with other and foreign supervisors. OSFI has formal agreements (MoUs) with banking supervisors in the US and UK (representing 65-70% of domestic banks' international exposures) as well as Hong Kong, covering information exchange and promoting regular contacts. These MoUs cover the above noted matters.

32. OSFI's supervisory framework applies to all federally regulated institutions, including subsidiaries of foreign banks. There are currently no foreign bank branches in Canada, although the legislation has recently been amended to permit foreign bank branching. Foreign bank subsidiaries, like domestic banks, are subject to an annual examination. As part of the licensing of a foreign bank subsidiary, the Superintendent will consider the nature and degree of supervision of the foreign bank in its home jurisdiction, especially with respect the home supervisor's practices of consolidated supervision.

33. **Assessment:** Full compliance



# Canada

## Securities Supervision

Prepared by a staff team from the International Monetary Fund, in the context of the Financial Sector Assessment Program (FSAP), on the basis of self-assessments provided by the Canadian authorities

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## **CANADA: OBSERVANCE OF THE IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION<sup>1</sup>**

1. This report provides an assessment of Canada's observance of and consistency with relevant international standards and core principles in the financial sector, as part of a broader assessment of the stability of the financial system. This assessment work by the IMF was undertaken under the auspices of the IMF-World Bank Financial Sector Assessment Program (FSAP) based on information up to October 1999. This has helped to place the standards assessments in a broader institutional and macroprudential context, and identify the extent to which the supervisory and regulatory framework has been adequate to address the potential risks in the financial system. The assessment has also provided a source of good practices in financial regulation and supervision in various areas.

2. The assessment covered (i) the Basel Core Principles for Effective Banking Supervision; (ii) the International Organization of Securities Commissions' (IOSCO) Objectives and Principles of Securities Regulation; (iii) the International Association of Insurance Supervisors' (IAIS) Supervisory Principles; (iv) the Committee on Payment and Settlement Systems' (CPSS) Core Principles for Systemically Important Payment Systems; and (v) the IMF's Code of Good Practices on Transparency in Monetary and Financial Policies. Such a comprehensive coverage of standards was needed as part of the financial system stability assessment for Canada in view of the increasing convergence in the activities of banking, insurance, and securities firms, and the integrated nature of the markets in which they operate. It should be noted that some of the standards are still in draft form, and some do not yet have a complete methodology to systematically assess compliance or consistency.<sup>2</sup> This module was prepared in consultation with the Canadian authorities in the context of the IMF FSAP mission that visited Canada in October 1999, and constitutes a summary report of the detailed assessments prepared by the mission.

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3. The assessment of standards and codes draws on the self-assessments of the Canadian authorities, and on field work of the undertaken October 11-22, 1999, based on a peer review process by Kai Barvell (Payment Systems, Sveriges Riksbank), Karl Driessen and Charles Siegman (Transparency Code, IMF), Alvir Hoffmann (Banking Supervision, Banco Central do Brasil), Rodney Lester (Insurance, World Bank), Michael Martinson (Banking Supervision, Board of Governors of the Federal Reserve System), Stefan Spamer (Banking Supervision, Deutsche Bundesbank), and Shane Tregillis (Securities, Australian Securities and Investments Commission). The expert team was coordinated by the IMF FSAP mission, led by V. Sundararajan, and comprised R. Barry Johnston, Karl Driessen, Haizhou Huang and Martin Cerisola. The assessment has been communicated to the authorities.

4. Overall, the assessment found a high degree of compliance that had contributed to a stable financial system. Minor deviations from Basel Core Principles of Effective Supervision were detected, which are addressed by proposals contained in the Policy paper.<sup>3</sup> Full compliance with the Core Principles for Systemically Important Payment Systems was noted for the Large Value Transfer System. Canada is broadly compliant with all principles of insurance regulation, and is broadly consistent with IOSCO Objectives and Principles of Securities Regulation. The complexity of federal/provincial regulatory arrangements, oversight of mutual funds, and resource limitations on the enforcement capacity of some securities commissions are areas of concern that are being addressed. There is a high degree of consistency with the Code of Good Practices on Transparency in Monetary and Financial Policies. The more specific findings in the area of securities supervision are discussed below.

#### **A. Background and Overview**

5. The Canadian securities industry, consisting of the exchanges, securities dealers and mutual funds, is modern and undergoing rapid change. The Canadian Exchanges represent around 2 per cent of world market capitalization with the TSE, by far the largest securities exchange in Canada with 1433 listed companies and a market capitalization of Can\$1.3 trillion at end-1998, accounts for 90 per cent of the value of shares traded on Canadian stock exchanges. Securities dealers are well capitalized. Mutual funds have been the fastest growing sector of the financial system in recent years reflecting changing investor preferences. Competitive pressures from the larger and more liquid US exchanges and alternative trading systems are forcing a significant restructuring of the exchanges and adaptation of the regulatory framework.

6. At its 1998 Annual Conference, the International Organization of Securities Commissions (IOSCO) adopted the *Objectives and Principles of Securities Regulation*, setting out 30 core principles of securities regulation, which could be used as a guide for supervisors of regulatory financial institutions dealing in securities trading. The principles are

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<sup>3</sup> Department of Finance, Canada (1999), "Reforming Canada's Financial Services Sector: A Framework for the Future," June 25.

based on three fundamental objectives of securities regulation: (a) the protection of investors; (b) ensuring that markets are fair, efficient and transparent; and (c) the reduction of systemic risk.

7. Canada has a well developed general legal and securities regulatory framework which on the basis of the questionnaire response and review process undertaken is consistent in most significant respects with implementation of the IOSCO Objectives and Principles of Securities Regulation. The current review identified a number of outstanding issues relating to implementation of the Principles. In nearly all the areas where implementation issues have been identified, there are active reform initiatives underway or proposed by securities regulators in Canada. There is a general concern of adequacy of resources—in particular for securities commissions that are not yet self-funded—and the associated limitations on capacity for enforcement. Also, in the context of the federal/provincial regulatory structure and reliance on self-regulatory organizations (SROs), there are issues related to the clarity of roles and responsibilities, including the absence of a formal structure bringing together federal and provincial regulators.<sup>4</sup> Current limitations on sharing of information with other regulators, to some extent due to the provisions of the *Canadian Charter of Rights and Freedoms*, are at odds with principles 11-13 on cooperation in regulation. There are also weaknesses in the adequacy of disciplinary procedures for auditors, and the level of compliance in the area of financial reporting and corporate disclosure. The rapid growth in mutual fund activity increases the relevance of several IOSCO principles, in particular those related to the governance requirements and oversight arrangements for mutual fund dealers. This has been addressed by the planned creation of the Mutual Funds Dealers Association, MFDA. In Quebec, the Bureau des Services Financiers will regulate the mutual fund intermediaries.

8. Canada fully complies with most of the IAIS prudential regulation principles, and broadly complies with the remainder. This section provides a summary of the main findings of a more detailed assessment of IOSCO Objectives and Principles of Securities Regulation. A tabular summary is provided in Table 1.

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<sup>4</sup> OSFI and the provincial securities regulators have formal information sharing arrangements and there are informal consultation and liaison arrangements involving provincial securities regulators, OFSI, and the Department of Finance. These include six-monthly informal discussions between the Superintendent of Financial Institutions and CSA, as well as regular liaison meetings between Finance and securities regulators. Informal liaisons on policy issues occur on an ongoing basis.

Table 1. Canada: Implementation of IOSCO Objectives and Principles <sup>1/</sup>

Principles	Practice	FC <sup>2/</sup>	BC <sup>3/</sup>	NC <sup>4/</sup>	Mat. NC <sup>5/</sup>	Comments
Principles Relating to the Regulator (1-5)	In general, there is clarity of roles, independence and accountability; and the regulators have adequate powers and capacity. There is a strong emphasis, often mandated in law, on the regulator adopting clear and consistent regulatory processes and there are requirements for the regulator and its staff to meet high professional standards.		X			There remain some residual issues as to clarity of roles of responsibilities in the context of the federal/provincial regulatory structure and reliance on SROs; the adequacy of the resources for those commissions that do not yet have self funding status; and the absence of any formal structure to bring together provincial securities and federal regulatory authorities.
Principles of Self-Regulation (6-7)	There is a well-developed scheme of self-regulation. Where there is formal recognition of SROs, the SRAs have adequate powers to conduct oversight. There are clear recognition criteria consistent with the matters identified in the IOSCO Principles, and the securities commissions are developing a coordinated review program.		X			There are some issues about the differences in formal status and oversight arrangements for SROs among the provinces and territories. The CSA is developing a national oversight program for SROs.
Principles for the Enforcement of Securities Regulation (8-10)	The inspection, investigation, surveillance, and enforcement powers are generally comprehensive. Where the securities commission is structured as an administrative tribunal, the commission itself has the ability to make compliance orders and impose other sanctions.		X			The self funded SRAs are still in the process of reaching target levels in the enforcement area, and a number of the other SRAs are pursuing self funding status. In a number of jurisdictions, the securities commission cannot impose fines or recover the costs of an administrative proceeding.
Principles for Cooperation in Regulation (11-13)	The major Canadian SRAs have information-sharing memoranda of understanding with a number of foreign regulators and share information informally with others.		X			There are limitations on the sharing of information with other regulators. Some provinces currently have proposed legislative amendments designed to address some of these limitations.
Principles for Issuers (14-16)	There are comprehensive standards for full, timely, and accurate disclosure of information to investors, and there is a comprehensive liability regime for prospectuses. The rules for change of control transactions are based on the treatment of security holders in a fair and equitable manner. The accounting standards enforced by the SRAs are comprehensive and based on GAAP.		X			Two remaining issues are the adequacy of the disciplinary procedures for auditors and level of current real compliance and enforcement activity in the area of financial reporting and corporate disclosure.

Principles for Collective Investment Schemes (17-20)	There is a comprehensive regime for product disclosure, distribution, and safekeeping of mutual fund assets established by national policies and instruments that operate throughout Canada. The rules also regulate redemption and valuation issues and restrict transactions between related parties. The current regime is currently being revised following extensive consultation. Moreover, a self-regulatory organization for mutual fund dealers is in the process of being established.		X			There are no requirements relating to the structure or governance of the manager, although there are restrictions on related party transactions and an obligation to use a qualified custodian.
Principles for Market Intermediaries (21-24)	There are detailed registration requirements for intermediaries. There is an active oversight program for intermediaries. The Canadian Investor Protection Fund (CIPF) provides a compensation scheme for customers. The CIPF, in conjunction with the SROs, has established national standards and reviews each SRO's examination process and conducts reviews of individual members on a rotational basis. An active monitoring and review process for intermediaries includes an early warning system for the financial condition of members. The Canadian Depository for Securities Limited (CDS) and CDCC have extensive risk management and well-defined default procedures in place.		X			In some jurisdictions, some dealers are not subject to any systematic compliance review activities by a regulatory authority. This is currently being addressed by the formation of the Managed Funds Dealers Association and proposals that all dealers belong to an SRO.
Principles for the Secondary Market (25-30)	The SRAs have broad oversight powers in relation to exchanges and secondary markets. The SRAs have the power to review any changes in rules or by Laws of the exchanges. The exchanges have an active process of market monitoring and the clearinghouses have well-developed risk management and default procedures in place.	X				

1/ IOSCO has not yet endorsed an assessment methodology in relation to the Objectives and Principles for Securities Regulation.

2/ FC: Fully compliant

3/ BC: Broadly compliant

4/ NC: Non-compliant

5/ Mat. NC: Materially non-compliant

## **B. Assessment of IOSCO Principles**

### **Principles 1–5**

**Relating to the regulator: (1) clarity of responsibilities; (2) independence and accountability; (3) powers and resources; (4) regulatory process; and (5) professional standards.**

9. The responsibilities and mandates of the provincial securities regulatory authorities are clearly stated in the legislation and other public documents. The regulators have wide-ranging functions and powers under statute, including in some cases, extensive rule-making powers. The responsibilities and relationships between securities regulatory authorities (SRAs) and other parts of the regulatory structure, such as SROs, are governed by a range of mechanisms including statutes, formal agreements, conditions attached to recognition criteria and a variety of informal arrangements.

10. The Canadian Securities Administrators (CSA) provides a structured forum for cooperation among provincial securities regulators where there appears to be well-developed formal and informal arrangements between the SRAs, SROs and other participants. The Joint Forum of Financial Market Regulators involving the CSA, the Canadian Council of Insurance Regulators (CCIR) and the Canadian Association of Pension Supervisory Authorities has also been formed to promote greater cooperation amongst market regulators.

11. Self-funding has improved the capacities of the five largest securities commissions, including in some cases, their ability to retain and attract high quality staff, increase their resources devoted to compliance, and upgrade their enforcement activities. Currently, however, these commissions remain below their target level of overall resources. Despite increased funding, the ability of some commissions to attract experienced, skilled staff remain constrained by limitations on employment conditions.

12. **Assessment:** The regulatory system is broadly consistent with implementation of the IOSCO principles for clarity of roles, and independence and accountability; and securities regulators have adequate powers and capacity. Some issues remain in relation to: (i) the clarity of roles of the federal/provincial regulatory structure and reliance on SROs; (ii) the adequacy of their resources for those commissions that do not yet have self funding; and (iii) the lack of any formal structure to bring together provincial securities and federal regulatory authorities.

### **Principles 6–7**

**Relating to self regulation: (6) use of self-regulatory organizations; and (7) SRO oversight and standards.**

13. The Canadian system has a well-developed scheme of self-regulation, and places considerable reliance on SROs. Where there is formal recognition of SROs, the SRAs have adequate powers to conduct oversight. There are clear recognition criteria consistent with the

matters identified in the IOSCO Principles, and the securities commissions are developing a coordinated review program.

14. **Assessment:** The Canadian regulatory system is broadly consistent with the implementation of IOSCO principles in this area, although there are some issues about the differences in formal status and oversight arrangements for SROs among the provinces and territories.

#### **Principles 8–10**

**Relating to the enforcement of securities regulation: (8) inspection powers; (9) enforcement powers; and (10) effective compliance program.**

15. While there are differences between the legislative provisions across the provinces and territories, the inspection, investigation, surveillance, and enforcement powers are generally comprehensive. Where the securities commission is structured as an administrative tribunal, the commission itself has the ability to make compliance orders and impose other sanctions. In a number of jurisdictions, the commission cannot impose fines or recover the costs of an administrative proceeding.

16. **Assessment:** The Canadian regulatory system is broadly consistent with implementation of the relevant IOSCO principles, although some issues about the adequacy of enforcement resources for some SRAs remain.

#### **Principles 11–13**

**Relating to cooperation in regulation: (11) information sharing authority; (12) information sharing mechanisms; and (13) assistance to foreign regulators.**

17. Information sharing between securities commissions in Canada is conducted informally at the operational level. In addition, a number of agreements with foreign securities regulators have been entered into. Memoranda of Understanding have been created to establish mechanisms of information sharing, including between several securities commissions and OSFI.

18. **Assessment:** Current limitations on the sharing of information with other regulators, resulting from constitutional protections, freedom of information legislation, and privacy legislation, are not fully consistent with implementation of the relevant IOSCO Principles. In Quebec and Ontario there are currently proposals to deal with some of these issues.

#### **Principles 14–16**

**Relating to issuers: (14) disclosure of material information; (15) fair treatment of holders of securities; and (16) accounting and auditing standards.**

19. National policies and instruments establish comprehensive standards for full, timely, and accurate disclosure of point of sale, periodic and other information to investors in the Canadian system, and there is a comprehensive liability regime for prospectuses. The SRAs

actively review prospectus documents before a distribution can commence; they also have the power to prevent the issue of a prospectus into the market by not granting a receipt or ordering a cease in trading. Exchange rules and securities regulations require material information to be provided to the market. The SEDAR system allows prospectus and other disclosure documents to be lodged and made available to the public electronically.

20. The rules for change-of-control transactions are based on the treatment of security holders in a fair and equitable manner. There are general protections in corporate and securities law designed to prevent any discrimination against minority shareholders.

21. The accounting standards enforced by the SRAs are comprehensive—based on generally accepted accounting concepts—and are comparable to financial reporting standards in other major jurisdictions.

22. **Assessment:** The Canadian regulatory system is consistent with implementation of the IOSCO principles for issuers in most significant respects. The two issues were the disciplinary procedures for auditors and the level of current compliance and enforcement activity in the area of financial reporting and corporate disclosure. The nature of the review did not allow a conclusive view on either issue to be reached.

#### **Principles 17–20**

**Relating to collective investment schemes: (17) eligibility and regulation standards; (18) rules on form and structure, segregation and client asset protection; (19) disclosure for suitability and value of investor's interest; and (20) asset valuation, pricing, and redemption.**

23. The mutual funds industry is a rapidly growing segment of the retail financial market in Canada. There is a comprehensive regime for product disclosure, distribution, and safekeeping of mutual fund assets established by national policies and instruments that operate throughout Canada. The rules also regulate redemption and valuation issues and restrict transactions between related parties. The current regime is currently being revised following extensive consultation. Moreover, a self-regulatory organization for mutual fund dealers is in the process of being established.

24. **Assessment:** The Canadian regulatory system is broadly consistent with the relevant IOSCO principles. In Canada, product and distribution activities of mutual funds are regulated rather than the fund manager. There are no requirements relating to the structure or governance of the fund manager, although there are restrictions on related party transactions, an obligation to use a qualified custodian to hold fund assets and general fiduciary obligation. The IOSCO principles are not explicit in this area, but the Canadian system does differ from most major jurisdictions in this respect. Although there is a legislated standard of care for mutual fund managers, the lack of explicit governance requirements for mutual fund managers is an issue.

#### **Principles 21–24**

**Relating to market intermediaries: (21) minimum entry standards; (22) capital and prudential requirements; (23) standards for internal organization and operational conduct; and (24) procedures for dealing with failure of market intermediary.**

25. There are detailed registration requirements for intermediaries that establish minimum entry standards, including those on financial and liquidity matters. There is an active oversight program for intermediaries, which includes annual renewal of registration, comprehensive monitoring of financial and capital standards, and regular compliance inspections. The Canadian Investor Protection Fund (CIPF) provides a compensation scheme for customers of up to \$1 million in the case of insolvency of a member.

26. The CIPF, in conjunction with the SROs, has established national standards covering capital, liquidity, insurance, internal controls, customer asset segregation and a range of other matters. While the primary responsibility for compliance reviews of members rests with the relevant SRO, CIPF annually reviews each SRO's examination process and conducts reviews of individual members on a rotational basis. An active monitoring and review process for intermediaries includes an early warning system for the financial condition of members. The Canadian Depository for Securities Limited (CDS) and Canadian Derivatives Clearing Corporation (CDCC) have extensive risk management and well-defined default procedures in place that are consistent with good practice in this area.

27. **Assessment:** The Canadian regulatory system is broadly consistent with implementation of the relevant IOSCO principles. Although a number of gaps in oversight arrangements remain, these are currently being addressed by the formation of the Managed Fund Dealers Association and proposals in several provinces that all dealers be required to belong to a SRO.

#### **Principles 25–30**

**Relating to the secondary market: (25) authorization and oversight of trading systems; (26) ongoing regulatory supervision of trading systems; (27) transparency of trading; (28) manipulation and other unfair trading practices; and large exposures, default risk, and market disruption; and (30) oversight of clearing and settlement systems.**

28. The SRAs have broad oversight powers in relation to exchanges and secondary markets. The SRAs have the power to review any changes in rules or by-laws of the exchanges. The exchanges have an active process of market monitoring and the clearing houses have well developed risk management and default procedures in place. While the securities commission routinely reviews changes to exchange rules and by-laws, a more general program reviewing exchange regulatory activities is a new development. The OSC has only recently established an infrastructure for exchange oversight and has commenced such a review of the Toronto Stock Exchange (TSE). In British Columbia, the British Columbia Securities Commission has reviewed the Vancouver Stock Exchange in the last few years.



29. **Assessment:** The Canadian regulatory system is broadly consistent with implementation of the relevant IOSCO principles.



# Canada

## Insurance Supervision

Prepared by a staff team from the International Monetary Fund, in the context of the Financial Sector Assessment Program (FSAP), on the basis of self-assessments provided by the Canadian authorities

International Monetary Fund  
June 2000

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## **CANADA: OBSERVANCE OF THE IAIS INSURANCE SUPERVISORY PRINCIPLES<sup>1</sup>**

1. This report provides an assessment of Canada's observance of and consistency with relevant international standards and core principles in the financial sector, as part of a broader assessment of the stability of the financial system. This assessment work by the IMF was undertaken under the auspices of the IMF-World Bank Financial Sector Assessment Program (FSAP) based on information up to October 1999. This has helped to place the standards assessments in a broader institutional and macroprudential context, and identify the extent to which the supervisory and regulatory framework has been adequate to address the potential risks in the financial system. The assessment has also provided a source of good practices in financial regulation and supervision in various areas.
2. The assessment covered (i) the Basel Core Principles for Effective Banking Supervision; (ii) the International Organization of Securities Commissions' (IOSCO) Objectives and Principles of Securities Regulation; (iii) the International Association of Insurance Supervisors' (IAIS) Supervisory Principles; (iv) the Committee on Payment and Settlement Systems' (CPSS) Core Principles for Systemically Important Payment Systems; and (v) the IMF's Code of Good Practices on Transparency in Monetary and Financial Policies. Such a comprehensive coverage of standards was needed as part of the financial system stability assessment for Canada in view of the increasing convergence in the activities of banking, insurance, and securities firms, and the integrated nature of the markets in which they operate. It should be noted that some of the standards are still in draft form, and some do not yet have a complete methodology to systematically assess compliance or consistency.<sup>2</sup> This module was prepared in consultation with the Canadian authorities in the context of the IMF FSAP mission that visited Canada in October 1999, and constitutes a summary report of the detailed assessments prepared by the mission.
3. The assessment of standards and codes draws on the self-assessments of the Canadian authorities, and on field work of the undertaken October 11-22, 1999, based on a peer review process by Kai Barvell (Payment Systems, Sveriges Riksbank), Karl Driessen and Charles

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<sup>1</sup> The work of the mission was coordinated by an FSAP team led by Mr. V. Sundararajan (IMF). Mr. Rodney Lester (World Bank) was the principal contributor to this module.

<sup>2</sup> The Basel Core Principles were issued in September 1997; a Core Principles Methodology was released in October 1999 by the Basel Committee on Banking Supervision. The Code of Good Practices on Transparency was adopted by the Interim Committee in September 1999; work on a supporting document is in progress. The IOSCO Objectives and Principles were issued in September 1998, and a detailed self-assessment methodology is being developed. A draft of the Core Principles for Systemically Important Payment Systems was issued for public comment in December 1999. The IAIS Insurance Supervisory Principles were issued in September 1997; a self-assessment program has been developed to assist member countries in evaluating compliance.

Siegmán (Transparency Code, IMF), Alvir Hoffmann (Banking Supervision, Banco Central do Brasil), Rodney Lester (Insurance, World Bank), Michael Martinson (Banking Supervision, Board of Governors of the Federal Reserve System), Stefan Spamer (Banking Supervision, Deutsche Bundesbank), and Shane Tregillis (Securities, Australian Securities and Investments Commission). The expert team was coordinated by the IMF FSAP mission, led by V. Sundararajan, and comprised R. Barry Johnston, Karl Driessen, Haizhou Huang and Martin Cerisola. The assessment has been communicated to the authorities.

4. Overall, the assessment found a high degree of compliance that had contributed to a stable financial system. Minor deviations from Basel Core Principles of Effective Supervision were detected, which are addressed by proposals contained in the Policy paper.<sup>3</sup> Full compliance with the Core Principles for Systemically Important Payment Systems was noted for the Large Value Transfer System. Canada is broadly compliant with all principles of insurance regulation, and is broadly consistent with IOSCO Objectives and Principles of Securities Regulation. The complexity of federal/provincial regulatory arrangements, oversight of mutual funds, and resource limitations on the enforcement capacity of some securities commissions are areas of concern that are being addressed. There is a high degree of consistency with the Code of Good Practices on Transparency in Monetary and Financial Policies. The more specific findings in the area of insurance supervision are discussed below.

#### **A. Background and Overview**

5. The Canadian insurance sector is mature, competitive and several Canadian life insurers have achieved a high market penetration overseas. The insurance sector has four main markets: life, property and casualty (P&C), health, and mortgage lenders. Approximately 22 million Canadians have some form of life insurance. Total worldwide investment assets under management amounted to \$267 billion in capital guaranteed products and \$153 billion in investment-linked products as at the end of the last fiscal year. Total domestic capital guaranteed net policyholder liabilities amounted to \$149 billion or 25 percent of the amount of domestic bank deposits. Even though the domestic insurance market is composed of 150 players, it is still relatively concentrated.

6. Life insurers are aggressively moving into the domestic wealth management business by developing and marketing a variant of mutual funds like products. The guarantees associated with these new products pose additional risks. A process of demutualization of major life insurance companies is also underway.

7. The IAIS has developed two sets of principles to date: (i) Insurance Supervisory Principles; and (ii) Principles Applicable to the Supervision of International Insurers and Insurance Groups and their Cross-Border Establishments. Standards based on these

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<sup>3</sup> Department of Finance, Canada (1999), "Reforming Canada's Financial Services Sector: A Framework for the Future," June 25.

principles so far cover only a small fraction of these principles, and deal with licensing, on-site inspection, and derivatives. In addition, insurance has a wider range of risk factors than banking, including a number of liability related risks which make supervision more a function of environment and country development than is the case with banking, where more specific and universal core principles have been possible. The principles do not capture the prudential requirements arising from product innovation and the associated buildup of contingent liabilities, including guarantees and exposures to increasingly complex derivative instruments.

8. Canada complies with the IAIS prudential regulation principles in almost all areas (Table 1). Variations generally reflect its unique legal history; for example the coexistence of common law and a civil code within one federation. The major explicit deviations include the following (i) marine insurance does not require the insurer to be licensed if the insurer only writes this class of business; (ii) the Minister of Finance, rather than the Superintendent, grants new licenses; however, in practice the Minister acts on the recommendation of the Supervisor, who places primary emphasis on the suitability of the new owners; (iii) the Supervisor does not have primary responsibility for setting corporate governance standards; (iv) ultimate responsibility for asset selection lies with directors; however, an overriding "prudent person" rule applies, augmented by a guidance note issued by OSFI; (v) dealings with non-Canadian licensed foreign reinsurers are controlled indirectly through non-allowance in capital adequacy/solvency tests; and (vi) OSFI is not automatically advised of findings regarding criminal activity affecting the insurance sector where the investigation was carried out by another government entity.

## **B. Assessment of IAIS Principles**

### **Principle 1.A: Licensing**

9. A company wishing to incorporate under the Insurance Companies Act must apply for letters patent according to a defined process. The authority to incorporate a federally registered insurance company rests with the Minister of Finance, however, in practice this is on a recommendation by the Superintendent of OSFI. Criteria are established including minimum capital, a sound business plan, owner track record in the financial services sector, and management skills. A foreign company must also have at least a five-year successful track record in its home country, proven expertise and an acceptable corporate name. In addition, the provinces must sign off on the marketing plan and the proposed product range; and a chief agent and an actuary, both Canadian residents, and a Fellow of the Canadian Institute of Actuaries (FCIA) in the latter case, must be appointed.

10. **Assessment:** The principle is met.

Table 1. Canada: Compliance with IAIS Insurance Supervisory Principles

CP	Principle	FC <sup>1/</sup>	BC <sup>2/</sup>	NC <sup>3/</sup>	Mat NC <sup>4/</sup>	Comments and Corrective Actions
1.A	Licensing		X			OSFI should have power to grant new licenses, possibly by delegation from the Minister of Finance. The Insurance Law should cover specialist Marine insurers
1.B	Changes in Control	X				
2.A	Corporate Governance	X				
2.B	Internal Controls	X				
3.A	Prudential – Assets	X				
3.B	Prudential – Liabilities	X				A mechanism is required to ensure greater consistency, across the insurance industry, of actuarial assumptions for the setting of fair value policy liabilities.
3.C	Capital Adequacy and Solvency	X				Best practice is in place (for highly developed insurance markets).
3.D	Derivatives and off balance sheet items	X				Separate insurer board compliance or risk committees, which receive regular risk management reports from management, should be established by law.
3.E	Reinsurance	X				
4.A	Financial reporting	X				Canada is one of the leaders in this area. The use of smoothed asset values, while possibly consistent with fair value liability valuation methods, is inconsistent with the mark to market approach adopted in other industrial countries. Profits on a mark to market basis could be included as a note to insurer accounts.
4.B	On site inspection – access to information	X				
5	Sanctions	X				Administrative penalties are to be introduced under the Policy paper proposals and this should provide for a suitably flexible approach.
6.A	Co-operation		X			OSFI should have full access to relevant information regarding fraudulent or other criminal activity affecting the institutions for which it is responsible.
6.B	Confidentiality	X				

1/ FC: Fully compliant

2/ BC: Broadly compliant

3/ NC: Non-compliant

4/ Mat. NC: Materially non-compliant

### Principle 1.B: Changes in Control

11. No person shall acquire control of a company or acquire or increase a significant interest in a class of shares without ministerial approval (the Superintendent can approve the acquisition of up to 10 percent of non-voting shares and increases in capital). If control of a company is changing, the requirements are broadly similar to those for a new license. Canada also has a number of rules requiring companies to be widely held once they get to a certain

size, defined in terms of equity. Additional rules apply if the acquirer is a financial institution (and a Bank in particular), and if it is a related company.

**Assessment: The principle is met.**

## **Principle 2: Corporate Governance and Internal Controls**

12. The Insurance Companies Act (ICA) has a large and comprehensive section on the roles and responsibilities of Directors and Officers. Insurance companies must have a minimum of seven directors and at least half (for a foreign subsidiary) or three quarters (for a domestic insurer) must be resident Canadians. Certain people are disqualified by virtue of their responsibilities or personal history from being a director. Normally, no more than two-thirds of the directors may be affiliated with the company and up to 50 percent of directors may be employees. Comprehensive law exists to cover the election of directors and further requires directors to meet at least 4 times a year. OSFI has reinforced this by issuing a letter on "Compliance with the Insurance Companies Act" reminding directors, officers and chief agents of their governance responsibilities and specifying a deadline of December 31, 2000 for implementation.

13. In the case of life insurers, the above procedures are supplemented by a "Program for Assessment of Regulatory Compliance with the Standards of Sound Business and Financial Practices for Life Insurance Companies (PARC)", which from 1999 must be reviewed by the Board Audit Committee. OSFI reviews all compliance documentation and auditors are required to report noncompliance under the "well being reporting requirements." When auditors, actuaries and directors sever connections with a company, the reasons should be communicated to the Supervisor. In addition, OSFI has the ability to veto the appointment of directors for problem companies.

14. OSFI has issued a detailed guideline on internal controls for life insurers and a guideline is in course of preparation for P & C companies. OSFI also meets with the external auditors after the annual audit and has periodic meetings with the auditing profession. In addition, the Standards of Sound Business and Financial Practices are very comprehensive, covering capital, credit risk, foreign exchange risk, securities portfolio management, real estate appraisals, product design and pricing, underwriting and liability management, interest rate risk management, liquidity management and internal controls.

15. **Assessment:** The principle is met.

## **Principle 3.A: Prudential Rules—Assets**

16. The Insurance Companies Act specifies that the directors of a company "will establish policies relating to investment and lending and policies that a reasonable and prudent person would apply with respect to a portfolio of investments and loans and the company must adhere to that policy." OSFI has issued guidelines on the Prudent Person Approach. In addition, there are clear limits on the types of subsidiary in which an insurer



may hold a substantial interest. Further legislated guidelines limit a company's aggregate investments in real estate and equities. Certain asset-related matters are also covered in the life insurance standards of business and financial practices, including capital, asset, and liability quality (product design and pricing, and underwriting). Similar standards are being developed for non-life companies. The "well being reporting requirement" for auditors also requires the auditor to report on any inappropriate or overly risky investments. Related-party transactions are explicitly covered in the legislation and the Conduct Review Committee of the board has specific responsibilities in the area. Foreign companies are required to maintain certain liquidity facilities in Canada. Asset valuation methods are specified under Canadian GAAP as modified by OSFI, and are designed to be consistent with liability valuation methods.

17. **Assessment:** The principle is met.

### **Principle 3.B: Prudential Rules–Liabilities**

18. The Insurance Companies Act specifies that "the actuary shall value actuarial and policy liabilities of the company and any other matter specified by the Superintendent." The Act goes on to say that "the actuary's valuation shall be in accordance with the generally accepted actuarial practice with such changes and additional directions as the Superintendent may determine." Standards of practice are set by the Canadian Institute of Actuaries (in consultation with the regulator, the industry and the Canadian Institute of Chartered Accountants). However, these are not prescriptive and specify no minimum valuation basis: considerable discretion remains with the appointed actuary. In the case of P&C companies the board may set a reserve higher than that established by the appointed actuary. In special circumstances the Superintendent can ask for a report from an independent external actuary. The Superintendent also has the power to override Canadian GAAP; however, this authority is used sparingly. A guideline exists for the treatment of reinsurance. Net reinsurance assets in respect of non-registered life insurance reinsurers are not admitted for solvency purposes.

19. **Assessment:** The principle is met.

### **Principle 3.C: Capital Adequacy and Solvency**

20. The current legislative minimum capital requirement for the incorporation of domestic life insurance companies and domestic P&C insurers is \$10 million. The Federal Canadian approach to life insurance solvency parallels the Basel Committee approach for banks, and is outlined in "Guideline A – Minimum Continuing Capital and Surplus Requirements for Life Insurers in Canada (MCCSR)" under which risk-based required capital is compared with capital available. The broad risk factors considered include asset default risk, mortality/morbidity/lapse risk, and interest margin pricing risk. Capital is allocated to two tiers according to the nature of the asset and insurers are expected to maintain a cushion over the minimum. Foreign life insurers must vest additional assets in accordance with an "Adequacy of Assets in Canada" test. P&C companies are also subject to a solvency test based on the excess of admitted assets over liabilities. Under the Insurance

Companies Act, the Superintendent can require a life company to increase capital and liquidity, as well as require a P&C Company to increase assets. In addition to static solvency testing Canada has introduced Dynamic Capital Adequacy Testing (DCAT) in which future cash flows are stress tested against assumed adverse developments. P&C companies will be brought into this framework over the next two years (including the introduction of a minimum capital test).

21. **Assessment:** The principle is met. However, provincial regulators continue to use more traditional approaches to solvency testing.

### **Principle 3.D: Derivatives and 'Off Balance Sheet' Items**

22. No explicit limitations on derivative trading apply, however the prudent person investment guidelines states that limits on currency and interest rate exposure should be established to contain risk, and that there should be policies detailing the circumstances under which the use of derivatives is permitted, as well as limits on type of instrument and counterparty.

23. In addition, an explicit OSFI guideline exists for derivatives, which requires senior management to specify which instruments may be purchased or written, and for which purposes and who has the relevant authorities. There is also a requirement that adequate capital is maintained to support the risks arising from derivatives. In particular if a derivative instrument results in an off-balance sheet exposure for a life insurer, then the potential credit exposure is determined by assigning a default factor appropriate to the counter party (similar treatment does not currently apply to P&C companies). The board is required to periodically review all significant policies pertaining to the institutions use of derivatives. Risks to be considered include market, credit, liquidity, and operations and systems, as well as legal issues.

24. **Assessment:** The principle is met.

### **Principle 3.E: Reinsurance**

25. Domestic reinsurers are subject to the same regulatory regime as direct insurers. The Governor-in-Council has the power to make regulations regarding reinsurance and has done so in the case of P&C insurance. This requires at least 25 percent premium retention and limits the amount reinsured with non-approved reinsurers to 25 percent of risks. OSFI assumes that the words "non-approved" are analogous to "not licensed in Canada", and places no reliance on the supervisor of a reinsurance company that is not so licensed. Reinsurance arrangements are reviewed by OSFI at the time of on-site inspections, and insurers are expected to consider the security of their reinsurers.

26. **Assessment:** The principle is met.

#### **Principle 4.A: Financial Reporting**

27. Statutory reports required for life insurers include quarterly financial and MCCSR returns, annual returns, an annual appointed actuary's report, a dynamic solvency testing report, disclosures of dividend policy, activities for the year of the Conduct Review Committee, details of any changes in Board membership, and an annual return of Directors and Auditors. All reports are subject to deadlines and OSFI can impose fines for late lodgment. P&C statutory returns are similar although not as onerous. The Insurance Companies Act specifies that directors have to place an annual statement before shareholders and policyholders and that this will be prepared in accordance with the Handbook of the Canadian Institute of Chartered Accountants unless otherwise specified by the Superintendent.<sup>4</sup> Typically auditors and the appointed actuary sign letters stating that they will rely on each other's findings. OSFI relies on the work of the external auditor as to the fairness of the accounts. It also advises the external auditor of any information that may be relevant to the formation of an opinion on the fairness of the financial statements.

28. **Assessment:** The principle is met.

#### **Principle 4.B: On-site Inspection and Access to Information**

29. The Superintendent can examine and inquire into the business and affairs of any insurer operating in Canada to ensure compliance with the Act and that the insurer is in sound financial condition. The Superintendent is required to report to the Minister after each such examination. The Superintendent has full right of access to all records, cash, assets and securities and can request information from the chief agent, actuary, directors, officers and auditor (provided this is reasonable) regarding the condition and affairs of the enterprise. The Superintendent also has the powers of a commissioner to obtain evidence under oath and can delegate this authority. OSFI routinely examines the following items: internal auditors reports, external auditor's working papers, board and board committee minutes, loan assets and provisions for non-performing loans (using outside credit consultants), the institutions risk management processes, and financial performance trends, both against itself and peer insurers and the actuaries' working documents. In addition, routine interviews are held with the senior offices of the insurer to review operations.

30. **Assessment:** The principle is met.

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<sup>4</sup> Canada has, uniquely, reconciled actuarial and accounting concepts in its financial reporting system. Fair value assets and liabilities are determined and a separate explicit allowance is made for possible adverse deviations. One consequence of this is that the true volatility of insurance company earnings may be understated.

### **Principle 5: Sanctions**

31. The Superintendent has extensive powers to impose temporary cease and desist instructions and to require remedial action if unsafe or unsound practices are in use or are contemplated by an insurer. A temporary order can be extended if the insurer does not make satisfactory representations. The Superintendent can apply to a court for an order. The Superintendent can also require that directors not be appointed if a company is under orders to maintain or improve its safety and soundness, subject to representations by that person. OSFI, however, cannot appoint directors. The Superintendent also has extensive powers to take possession of a company, if the company is seriously compromised, for up to 16 days and for longer periods if the Minister does not intervene. A company has ten days to make representations in such circumstances. The Superintendent can also apply to the Attorney General to wind up a company of which he has taken possession.

32. Penalties for breaches of the Act can be up to Can\$5 million for a corporation that is convicted on indictment. Administrative penalties are not available but are planned for inclusion under the 1999 Policy paper. The Policy paper also proposes that the Superintendent will have the power to remove directors and officers of insurers in certain circumstances.

33. **Assessment:** The principle is met.

### **Principles 6.A and 6.B: Cooperation and Confidentiality**

34. OSFI does not have any formal relationships with any foreign insurance supervisors. While OSFI reviews the worldwide position of foreign branches and subsidiaries in Canada, the focus remains on the ability of the branch or subsidiary to stand on its own assets vested in Canada. Where OSFI has concerns that deteriorating results worldwide could create problems in Canada, it seeks regular contact with the foreign home supervisor. Where OSFI is the home supervisor, it does not have a standing protocol with foreign supervisors to share information at any particular level or to alert a foreign supervisor to a problem. Only in very rare cases, where a branch or subsidiary materially contributes to a company's overall results, would OSFI examiners leave Canada to perform an on-site examination.

35. All information obtained by OSFI as a result of administering or enforcing an act of Parliament is confidential. Legislation does not restrict the information that OSFI as supervisor may provide to other supervisors, whether domestic or foreign, other than that the information must be used solely for prudential purposes and be treated as confidential. OSFI does not have any legal responsibility to pass information on criminal activities onto a host supervisor as this responsibility rests with the Royal Canadian Mounted Police (RCMP). If a home supervisor uncovered criminal activities while carrying out an examination in Canada, it would not be obliged to inform OSFI of these activities.

36. **Assessment:** Partial compliance with Principle 6.A; Principle 6.B is met.

# Canada

## Payment Systems

Prepared by a staff team from the International Monetary Fund, in the context of the Financial Sector Assessment Program (FSAP), on the basis of self-assessments provided by the Canadian authorities

International Monetary Fund  
June 2000

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## **CANADA: OBSERVANCE OF THE CPSS CORE PRINCIPLES FOR SYSTEMICALLY IMPORTANT PAYMENT SYSTEMS<sup>1</sup>**

1. This report provides an assessment of Canada's observance of and consistency with relevant international standards and core principles in the financial sector, as part of a broader assessment of the stability of the financial system. This assessment work by the IMF was undertaken under the auspices of the IMF-World Bank Financial Sector Assessment Program (FSAP) based on information up to October 1999. This has helped to place the standards assessments in a broader institutional and macroprudential context, and identify the extent to which the supervisory and regulatory framework has been adequate to address the potential risks in the financial system. The assessment has also provided a source of good practices in financial regulation and supervision in various areas.

2. The assessment covered (i) the Basel Core Principles for Effective Banking Supervision; (ii) the International Organization of Securities Commissions' (IOSCO) Objectives and Principles of Securities Regulation; (iii) the International Association of Insurance Supervisors' (IAIS) Supervisory Principles; (iv) the Committee on Payment and Settlement Systems' (CPSS) Core Principles for Systemically Important Payment Systems; and (v) the IMF's Code of Good Practices on Transparency in Monetary and Financial Policies. Such a comprehensive coverage of standards was needed as part of the financial system stability assessment for Canada in view of the increasing convergence in the activities of banking, insurance, and securities firms, and the integrated nature of the markets in which they operate. It should be noted that some of the standards are still in draft form, and some do not yet have a complete methodology to systematically assess compliance or consistency.<sup>2</sup> This module was prepared in consultation with the Canadian authorities in the context of the IMF FSAP mission that visited Canada in October 1999, and constitutes a summary report of the detailed assessments prepared by the mission.

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<sup>1</sup> The work of the mission was coordinated by an FSAP team led by Mr. V. Sundararajan (IMF). Mr. Kai Barvell (Central Bank of Sweden) was the principal contributor to this module.

<sup>2</sup> The Basel Core Principles were issued in September 1997; a Core Principles Methodology was released in October 1999 by the Basel Committee on Banking Supervision. The Code of Good Practices on Transparency was adopted by the Interim Committee in September 1999; work on a supporting document is in progress. The IOSCO Objectives and Principles were issued in September 1998, and a detailed self-assessment methodology is being developed. A draft of the Core Principles for Systemically Important Payment Systems was issued for public comment in December 1999. The IAIS Insurance Supervisory Principles were issued in September 1997; a self-assessment program has been developed to assist member countries in evaluating compliance.

3. The assessment of standards and codes draws on the self-assessments of the Canadian authorities, and on field work of the undertaken October 11-22, 1999, based on a peer review process by Kai Barvell (Payment Systems, Sveriges Riksbank), Karl Driessen and Charles Siegman (Transparency Code, IMF), Alvir Hoffmann (Banking Supervision, Banco Central do Brasil), Rodney Lester (Insurance, World Bank), Michael Martinson (Banking Supervision, Board of Governors of the Federal Reserve System), Stefan Spamer (Banking Supervision, Deutsche Bundesbank), and Shane Tregillis (Securities, Australian Securities and Investments Commission). The expert team was coordinated by the IMF FSAP mission, led by V. Sundararajan, and comprised R. Barry Johnston, Karl Driessen, Haizhou Huang and Martin Cerisola. The assessment has been communicated to the authorities.

4. Overall, the assessment found a high degree of compliance that had contributed to a stable financial system. Minor deviations from Basel Core Principles of Effective Supervision were detected, which are addressed by t proposals contained in the Policy paper.<sup>3</sup> Full compliance with the Core Principles for Systemically Important Payment Systems was noted for the Large Value Transfer System. Canada is broadly compliant with all principles of insurance regulation, and is broadly consistent with IOSCO Objectives and Principles of Securities Regulation. The complexity of federal/provincial regulatory arrangements, oversight of mutual funds, and resource limitations on the enforcement capacity of some securities commissions are areas of concern that are being addressed. There is a high degree of consistency with the Code of Good Practices on Transparency in Monetary and Financial Policies. The more specific findings in the area of payment system supervision are discussed below.

#### **A. Background and Overview**

5. The major payment and clearing systems in Canada are the Large Value Transfer System (LVTS) for large value payments, the Debt Clearing System (DCS) for transactions involving federal government treasury bill and bonds and private sector money market securities (both system being overseen by the Bank of Canada, under the Payment Clearing and Settlement Act of 1996) and the Automated Clearing Settlement System (ACSS) primarily for retail payments. The LVTS and ACSS are operated by a private organization, the Canadian Payments Association (CPA), in accordance with the Canadian Payments Association Act, which came into force in 1980. As of July 28, 1999, the CPA membership consisted of 143 member institutions; the Bank of Canada, 59 chartered banks, 26 credit union centrals and federations, 39 trust, mortgage and loan companies and eighteen other deposit-taking institutions. The retail payments are primarily based on checks even though card-payments are increasing, and some 10 percent of large value payments continues to be paper-based.

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<sup>3</sup> Department of Finance, Canada (1999), "Reforming Canada's Financial Services Sector: A Framework for the Future," June 25.

6. The risk control systems in LVTS are well developed and include the use of caps and collateral pledged by the private sector participants. In the unlikely event that two or more participants fail on the same day, during the operating hours of LVTS with an aggregate net debit position in the survivors' payment stream that exceeds the total value of collateral pledged to the system by the participants, the Bank of Canada has guaranteed that the system will settle. In other cases of multiple failures, the system would settle using collateral pledged by the participants, without a need for the Bank of Canada guarantee.

7. There exists a substantial regulatory framework for the clearing and settlement systems as well as for their oversight. The LVTS has been designated for oversight—for reasons of systemic importance—under the Payment Clearing and Settlement Act, and complies with all 10 draft core principles for systemically important payment systems (Table 1). However, the review noted that although the value of large-value payments through the ACSS has declined substantially, and now accounts for a very small percentage of total ACSS transactions, the ACSS will need to be formally assessed for its capacity to pose systemic risk. This assessment will occur at the end of the transition phase during which large-value payments are migrating to the LVTS.<sup>4</sup> If the ACSS were to be judged capable of posing systemic risk, then the Core Principles would be applied to this system.

## **B. Assessment of CPSS Principles**

### **Principle I**

#### **Well-founded legal basis in all relevant jurisdictions.**

8. There are well-developed laws in Canada governing contracts, insolvency, anti-competitive behavior, etc. that have general application to individuals, institutions and markets in the economy. In addition, there are laws that are specifically applicable to the payments system. The Canadian Payments Association (CPA), the operator of LVTS, is a body incorporated by an Act of Parliament, with the authority to operate payment systems and to create rules governing the operation of such systems. The arrangements that govern the relationships among direct participants in LVTS are in the form of a by-law or rules. The provisions of the by-laws are reinforced by the fact that the LVTS is designated for oversight under the Payment Clearing and Settlement Act (PCSA). The PCSA provides immunity to the LVTS by preventing creditors of failed LVTS participants from challenging any of the LVTS rules and any outcome resulting from the application of those rules.

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<sup>4</sup> A CPA committee is examining ways in which remaining large-value payments can be migrated from the ACSS to the LVTS and the BoC is encouraging the timely migration of these payments.



Table 1. Canada: Compliance with the CPSS Draft Core Principles for Payment Systems

CP	Principle	FC <sup>1/</sup>	BC <sup>2/</sup>	Comments and Corrective Actions
1	The system should have a well-founded legal basis in all relevant jurisdictions.	X		Some of the recent legislative changes supporting the operation of the LVTS have not been "tested" in court, in circumstances involving a participant failure, but expert legal opinion is that the legislative changes are sound and robust.
2	The system's rules and procedures should enable participants to have a clear understanding of the system's impact on each of the financial risks they incur through participating in it.	X		
3	The system should have clearly defined procedures for the management of credit risks and liquidity risks, which specify the respective responsibilities of the system operator and participants, and which provide appropriate incentives to manage and contain risk.	X		
4	The system should provide prompt final settlement on the day of value, preferably during the day, and at a minimum at the end of the day.	X		Intra-day finality is obtained through the risk control mechanism in combination with the guarantee for settlement given by the Bank of Canada.
5	A system in which multilateral netting takes place should, at a minimum, be capable of ensuring the timely completion of daily settlements in the event of an inability to settle by the participant with the largest single settlement obligation.	X		Risk control arrangements including collateral pledged by the private sector participants ensure that the minimum principle is met. In the unlikely event that two or more participants fail on the same day, during the operating hours of LVTS with an aggregate net debit position in Tranche II that exceeds the total value of collateral pledged to the system by the participants, the Bank of Canada guarantee would be necessary for the system to settle.
6	Assets for settlement should preferably be a claim on the central bank; where other assets are used, they should carry little or no credit risk.	X		
7	The system should ensure a high degree of security and operational reliability and should have contingency arrangements for timely completion of daily processing.	X		
8	The system should provide a means of making payments which is practical for the markets it serves and efficient for the economy.	X		The system has only been in use for nine months, and so far there are no signs of system inefficiencies. The system has been designed to economize on the use of collateral.
9	The system should have objective and publicly disclosed criteria for participation, which permit fair and open access.	X		
10	Governance of the system should be effective, transparent, and accountable.	X		The mission recommends that the forthcoming legislation should codify the primary responsibility of the Bank of Canada for systemic risk issues, and that the governance structure of the CPA is reviewed to diminish the prospect of conflict of interest for the Bank of Canada.

1/ FC: Fully compliant

2/ BC: Broadly compliant

9. While no gaps in the domestic legal environment vis-à-vis LVTS were identified, some of the recent legislative changes supporting the operation of the LVTS have not been tested in court in circumstances involving a participant failure. Nevertheless, based on an informed legal analysis and expert opinion, the legal environment appears robust.

10. **Assessment:** Full compliance.

### **Principles II–III**

#### **Understanding of the system's impact on risks; and procedures for the management of risks and liquidity risks.**

11. The LVTS by-laws and associated rules give participants a clear understanding of the risks incurred by participating in the system. The system design and procedures provide incentives for the participants to manage and contain these risks: (i) the system operates in real time, and payment messages have to pass real-time risk control tests before being accepted by the system; (ii) participants can decide whether they wish to grant intraday credit to other participants or not; and if they grant a credit they have an incentive to manage this exposure carefully; (iii) collateral to support the use of Tranche I or Tranche II payments is pledged directly to the BoC, ensuring immediate access to liquidity; (iv) the CPA determines whether prospective participants are technically capable of meeting LVTS requirements. The by-laws and CPA rules cover participant withdrawal both in normal and abnormal situations.

12. **Assessment:** Full compliance.

### **Principles IV–VI**

#### **Final settlement; inability to settle by the participant with the largest single settlement obligation; and assets for settlement.**

13. The LVTS meets Principles IV and V although the actual settlement does not take place until the evening. There exists a risk-control mechanism, which ensures that settlement will take place even if the largest participant defaults. Limits, both bilateral and multilateral, control the exposures that any one participant can create in the LVTS. The guarantee of the BoC will, if necessary, be used in the unlikely circumstance of default by at least two participants on the same day, during the operating hours of LVTS, and whose aggregate net debit position in Tranche II exceeds the total value of collateral pledged to the system. Regarding Principle VI, the LVTS uses claims on the central bank to settle net payment obligations among the participants.

14. **Assessment:** Full compliance.

### **Principle VII**

#### **Security and operational reliability; and contingency arrangements.**

15. LVTS uses SWIFT for the transmission of payment instructions, which provides a highly secure and reliable means of sending payment instructions. Controls are in place to ensure that only authorized users access the LVTS system. LVTS has a secondary operation

site, in a geographically separate part of the country relative to its primary site. Back-up processing is tested regularly. There exist emergency committees to deal with problems in LVTS or in other systems critical to the functioning of LVTS, mainly the DCS, which is used by LVTS participants to pledge securities to the BoC to support the use of intra-day credit in the two payment streams in the LVTS. The recovery time in DCS to bring the systems back to full operations following a disaster at the primary site has been shortened to two hours, the same as in LVTS. Contingency plans have been developed, and an independent auditing firm carries out an annual audit of the LVTS arrangements for controlling a variety of operational risks.

16. **Assessment:** Full compliance.

### **Principle VIII**

#### **Practical for the markets and efficient for the economy.**

17. The LVTS was developed by private sector financial institutions under the auspices of the CPA. It fully addresses the central bank's concerns about systemic risk. The private sector participants were very intensely focussed on creating the least cost arrangement for processing large-value and time-sensitive payments. The system minimizes the amount of collateral necessary to support the use of intra-day credit, while delivering real-time processing of payment messages, certainty of settlement, and intra-day receiver finality. There do not appear to be any signs of system inefficiencies.

18. The BoC guarantees that settlement will take place at the end of the day. An explicit central bank guarantee of a payment system is unusual in developed economies most of which use real-time gross settlement systems (RGTS), and even if the risk is very small, a guarantee of the payment system still involves risk. However, the BoC has concluded that the relative cost of the risk that the guarantee would ever be used, is smaller than the cost to the participants of pledging a larger amount of collateral to cover the possibilities of multiple participant failures, however remote, and that the guarantee thus is to be seen as a "public good".

19. **Assessment:** Full compliance.

### **Principle IX**

#### **Objective and publicly disclosed criteria for participation.**

20. The criteria for becoming a participant in the LVTS are stated in its by-laws and allow all members of the CPA, at present 143, to become a member in LVTS. There are no other criteria for becoming a member. In order to be able to make Tranche I payments, the participant must have funds in their account at the BoC or collateral pledged to the BoC; or it must have received a bilateral credit line from the other participants in regard to a Tranche II payment.

21. **Assessment:** Full compliance.

**Principle X**

**Governance of the system should be effective, transparent and accountable.**

22. The governance of the LVTS seems to be effective, transparent, and accountable. The LVTS is owned and operated by the CPA. The BoC has designated the LVTS under the PCSA, which means that the Central Bank is the overseer of the system. The CPA operates under an Act of Parliament, which specifies membership criteria, the composition of the board of directors, public disclosure, and other requirements. The CPA has a board of directors responsible for the operation of the LVTS, and the BoC is responsible for appointing the chairperson. The cabinet of the federal government must approve all by-laws, and thus provides a form of external oversight.

23. **Assessment:** Full compliance.

# Canada

## Transparency of Monetary and Financial Policies

Prepared by a staff team from the International Monetary Fund, in the context of the Financial Sector Assessment Program (FSAP), on the basis of self-assessments provided by the Canadian authorities

International Monetary Fund  
June 2000

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## **CANADA: OBSERVANCE OF THE CODE OF GOOD PRACTICES ON TRANSPARENCY IN MONETARY AND FINANCIAL POLICIES<sup>1</sup>**

1. This report provides an assessment of Canada's observance of and consistency with relevant international standards and core principles in the financial sector, as part of a broader assessment of the stability of the financial system. This assessment work by the IMF was undertaken under the auspices of the IMF-World Bank Financial Sector Assessment Program (FSAP) based on information up to October 1999. This has helped to place the standards assessments in a broader institutional and macroprudential context, and identify the extent to which the supervisory and regulatory framework has been adequate to address the potential risks in the financial system. The assessment has also provided a source of good practices in financial regulation and supervision in various areas.

2. The assessment covered (i) the Basel Core Principles for Effective Banking Supervision; (ii) the International Organization of Securities Commissions' (IOSCO) Objectives and Principles of Securities Regulation; (iii) the International Association of Insurance Supervisors' (IAIS) Supervisory Principles; (iv) the Committee on Payment and Settlement Systems' (CPSS) Core Principles for Systemically Important Payment Systems; and (v) the IMF's Code of Good Practices on Transparency in Monetary and Financial Policies. Such a comprehensive coverage of standards was needed as part of the financial system stability assessment for Canada in view of the increasing convergence in the activities of banking, insurance, and securities firms, and the integrated nature of the markets in which they operate. It should be noted that some of the standards are still in draft form, and some do not yet have a complete methodology to systematically assess compliance or consistency.<sup>2</sup> This module was prepared in consultation with the Canadian authorities in the context of the IMF FSAP mission that visited Canada in October 1999, and constitutes a summary report of the detailed assessments prepared by the mission.

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<sup>2</sup> The Basel Core Principles were issued in September 1997; a Core Principles Methodology was released in October 1999 by the Basel Committee on Banking Supervision. The Code of Good Practices on Transparency was adopted by the Interim Committee in September 1999; work on a supporting document is in progress. The IOSCO Objectives and Principles were issued in September 1998, and a detailed self-assessment methodology is being developed. A draft of the Core Principles for Systemically Important Payment Systems was issued for public comment in December 1999. The IAIS Insurance Supervisory Principles were issued in September 1997; a self-assessment program has been developed to assist member countries in evaluating compliance.

3. The assessment of standards and codes draws on the self-assessments of the Canadian authorities, and on field work of the undertaken October 11-22, 1999, based on a peer review process by Kai Barvell (Payment Systems, Sveriges Riksbank), Karl Driessen and Charles Siegman (Transparency Code, IMF), Alvir Hoffmann (Banking Supervision, Banco Central do Brasil), Rodney Lester (Insurance, World Bank), Michael Martinson (Banking Supervision, Board of Governors of the Federal Reserve System), Stefan Spamer (Banking Supervision, Deutsche Bundesbank), and Shane Tregillis (Securities, Australian Securities and Investments Commission). The expert team was coordinated by the IMF FSAP mission, led by V. Sundararajan, and comprised R. Barry Johnston, Karl Driessen, Haizhou Huang and Martin Cerisola. The assessment has been communicated to the authorities.

4. Overall, the assessment found a high degree of compliance that had contributed to a stable financial system. Minor deviations from Basel Core Principles of Effective Supervision were detected, which are addressed by proposals contained in the Policy paper.<sup>3</sup> Full compliance with the Core Principles for Systemically Important Payment Systems was noted for the Large Value Transfer System. Canada is broadly compliant with all principles of insurance regulation, and is broadly consistent with IOSCO Objectives and Principles of Securities Regulation. The complexity of federal/provincial regulatory arrangements, oversight of mutual funds, and resource limitations on the enforcement capacity of some securities commissions are areas of concern that are being addressed. There is a high degree of consistency with the Code of Good Practices on Transparency in Monetary and Financial Policies. The more specific findings in the area of transparency of Monetary and Financial Policies are discussed below.

5. Overall, the general governance environment in Canada is quite disposed towards transparency, and the degree of transparency in the area of monetary and financial policies is high. Transparency is often an operating principle, built on a longstanding tradition. The legislative framework—which includes an Access to Information Act—is supplemented by an open environment that favors release of statements, and actively seeks input from the public for policy initiatives. At the same time, efforts are under way to strengthen the transparency aspects of financial and monetary policies, including through greater use of the internet and greater responsiveness to the public's demand for additional openness. A tabular summary of consistency with the Code of Good Practices on Transparency in Monetary and Financial Policies is provided in Table 1. Transparency practices in the following domains are reviewed: (i) monetary policy; (ii) banking and insurance supervision; (iii) securities supervision; (iv) payment systems oversight; and (v) deposit insurance.

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<sup>3</sup> Department of Finance, Canada (1999), "Reforming Canada's Financial Services Sector: A Framework for the Future," June 25.

## **A. Transparency in Monetary Policies**

6. The following considers the transparency practices in Canada in the area of monetary policy as they relate to the broad principles underlying the IMF Code of Good Practices on Transparency in Monetary and Financial Policies. The Code identifies desirable transparency practices for central banks in their conduct of monetary policy. In making the objectives of monetary policy public, the central bank enhances the public's understanding of what it is seeking to achieve, and provides a context for articulating its own policy choices, thereby contributing to the effectiveness of monetary policy. Further, by providing the private sector with a clear description of the considerations guiding monetary policy decisions, transparency about the policy process makes the monetary policy transmission mechanism generally more effective. By providing the public with adequate information about its activities, the central bank can establish a mechanism for strengthening its credibility by matching its actions to its public statements, and ensure that market expectations can be formed efficiently.

### ***Background and overview***

7. Monetary policy in Canada is conducted in an inflation targeting framework which includes strong transparency and accountability arrangements to forge credibility. The inflation target, currently defined as a range between 1 and 3 percent per annum for core inflation (i.e., excluding food, energy, and the effect of indirect taxes), is agreed and announced jointly by the Department of Finance and the BoC. As its main operating instrument, the BoC sets an interest rate band of 0.5 percent around a target overnight rate by offering standing deposit and borrowing facilities to participants in the LVTS payment system, with a view to maintaining a path of monetary expansion consistent with the inflation target.<sup>4</sup>

### ***Clarity of roles, responsibilities, and objectives***

8. The ultimate objectives of the BoC are specified in general terms in the preamble to the BoC Act, and include regulating credit and currency in the best interest of the economic life of the nation, controlling and protecting the external value of the Canadian dollar, mitigating fluctuations in trade, production, prices and employment, and, more generally, promoting the economic and financial welfare of Canada. The current inflation targeting framework clearly defines the inflation objective, and clarifies that maintaining low inflation is given primacy among BoC objectives—as a means to achieving the broader goals of the preamble—and thus increases transparency. Broad modalities of accountability for monetary

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<sup>4</sup> For a more detailed description of the monetary policy framework used by the BoC, see Donna Howard, "A Primer on the Implementation of Monetary Policy in the LVTS Environment", in Bank of Canada Review, Autumn 1998.



policy and other responsibilities are clearly specified in the BoC Act. Foreign exchange policy is assigned to the Minister of Finance, with the BoC playing an agency role. This Act also contains the provision for a "Government Directive," which outlines clearly the exceptional circumstances of a Ministerial override of monetary policy decisions, and the associated disclosure policy. Terms of appointment of the Governor, including disclosure procedures for removal for cause, are also specified in legislation.

9. The institutional relationship between monetary and fiscal operations is clearly defined, with the BoC designated as the fiscal agent for the government. The amounts and conditions of net credit to government are disclosed, including through frequent balance sheet updates. Other agency roles, including in foreign exchange operations and government debt management, are also clearly specified and detailed in public documentation. In this regard, the BoC has issued a series of guidelines and notes detailing the terms and conditions of auctions of government securities.

10. **Assessment:** Fully consistent with the Code.

***Open process for formulating and reporting policy decisions***

11. The monetary policy framework, instruments, and targets are disclosed and explained, including in speeches and periodic reports. For the inflation targeting framework to operate efficiently and coordinate inflation expectations, credibility of the BoC plays a crucial role. Thus, transparency is a strategic operating principle for the BoC in the conduct of its policies and activities, and BoC management is devoting more attention and resources to achieve greater transparency and better communication with the public.<sup>5</sup> In this vein, progress in achieving its objectives is reported in semi-annual monetary policy reports<sup>6</sup> as well as the annual report. There is no permanent policy-making body apart from a Governing Council, which is internal to the BoC. Changes in policy settings, e.g., in the band for

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<sup>5</sup> Transparency in monetary policy has also become a focus of the BoC research program. A recent research paper ("Greater Transparency in Monetary Policy: Impact on Financial Markets" by Phillippe Muller and Mark Zelmer, Bank of Canada, Technical Report No. 86, August 1999) examines whether the greater transparency employed by the BoC has improved financial markets' understanding of the conduct of monetary policy. The empirical results suggest that the BoC efforts at increasing transparency appear to have improved the efficiency of markets by facilitating more rapid adjustment in interest rates and the exchange rate.

<sup>6</sup> The Monetary Policy Report, Bank of Canada, November 1999, contains a discussion of current economic and financial developments (including the inflation rate, exchange and interest rates), the outlook for inflation and the key underlying assumptions of inflation forecasts.

overnight interest rates, are immediately disclosed and explained. Substantive policy changes are subject to extensive public consultation.

12. **Assessment:** Fully consistent with the Code.

***Public availability of information***

13. Canada subscribes to and meets the specifications of the SDDS. The BoC publishes its balance sheet weekly, monthly, and annually; the balance sheet provides aggregate information on lending to the banking sector and to government. Information on emergency lending can be gleaned from the balance sheet, in combination with the monthly publication of individual bank balance sheets. The BoC maintains public information services, which offer a publication program with a wide array of documentation, and which also support the information requirements of the inflation targeting framework.

14. **Assessment:** Fully consistent with the Code.

***Accountability and assurances of integrity***

15. The Governor is required to consult regularly with the Minister of Finance, and appears before parliamentary committees, including after the publication of the Monetary Policy Report and the Annual Report. The financial statements of the BoC are audited by external auditors; internal audit arrangements are the responsibility of the Audit Committee of the Board of Directors of the BoC. Operating income and expenditure are included in the annual financial statements. Standards for the conduct of personal financial affairs are published for the Governor and Senior Deputy Governor; those for staff are available to the public. Currently, legal protection for staff is provided for certain activities performed in good faith under the PCS Act.

16. **Assessment:** Fully consistent with the Code. Improved legal protection for staff is currently being proposed to also cover staff actions in the pursuit in good faith of other activities of the BoC.

**B. Transparency of Financial Policies**

17. This section discusses transparency practices by financial agencies responsible for banking and insurance supervision, securities supervision, payment systems oversight, and deposit insurance. Transparency in financial policies is important, inter alia, in promoting public confidence in the financial system, and in helping to reduce costs of regulation, and thus can improve financial sector efficiency. Greater transparency in financial policies also helps to promote market discipline by more clearly delineating the roles and responsibilities of the regulators versus the private sector.

## **Banking and insurance supervision**

### ***Background and overview***

18. The Office of the Superintendent of Financial Institutions (OSFI) is the agency responsible for supervision and oversight of both the banking and insurance sector. Overall, transparency practices of OSFI are of high quality. The roles, responsibilities, and objectives are generally clearly defined in legislation; the policy formulation and reporting process is transparent and well developed; information on the relevant policies is widely available; and the level of accountability is high, and the degree of assurance of integrity appropriate. Also, OSFI discloses its mandate through its mission statement, which is published widely, including in the OSFI bulletin (a stakeholder bulletin), its website, and the annual report. OSFI is also required by the OSFI Act to report on progress made by financial institutions in enhancing disclosure of information on financial condition. It has issued several guidelines to assist banks and other financial institutions with disclosure, including on derivatives and credit and market risk management.

19. Disclosure by financial institutions is a key element in the emerging regulatory paradigm in the insurance sector, with the purported advantage of using the market to discipline management and boards of directors. Canada is one of the first countries with high levels of disclosure and reporting consistent with Canadian GAAP. Nevertheless, actuaries have retained wide authority to set assumptions, which vary widely in practice. This is a source of concern for OSFI, given the fact that key items such as future investment returns and mortality/morbidity do not lend themselves to huge variation. Thus effective market discipline may require even greater disclosure of actuarial assumptions.

### ***Clarity of roles, responsibilities, and objectives***

20. The broad objectives—regulating financial institutions so as to contribute to public confidence from a safety and soundness perspective—and the institutional framework—including the broad modalities of accountability and terms of appointment of the Superintendent—for OSFI are defined in the OSFI Act, the Bank Act, the Insurance Companies Act, and others, and explained in various publications. The relationship with other federal financial agencies such as CDIC and BoC in coordinating bodies as the FISC and SAC are publicly disclosed.

21. Banks are federally regulated, and securities firms fall under the jurisdiction of the provinces. However, banks own the largest securities firms. The Hockin-Kwinter Accord (1987) delineates regulatory responsibilities between OSFI and the Ontario Securities Commission (OSC), and the Bank Act makes it clear that OSFI is ultimately responsible for banks on a consolidated basis. Nevertheless, the distinction between the products offered by banks and securities firms is disappearing, and more of banks' activities take place on the books of its securities subsidiaries. At the same time, banks have substantially increased their own securities operations. In addition, banks face a multitude of regulators when offering securities products.

22. **Assessment:** Broad consistency with the Code; one area for improvement is the clarity of roles and responsibilities with regard to the supervision of securities activities of banks. Clarity of roles and responsibilities is important for at least two reasons: (i) complicated arrangements lead to uncertainty in interpretation and thus to higher cost; and (ii) accountability is easier to assign if roles and responsibilities are clearly specified. The arrangements for regulating banks and securities firms suffer in both respects. An audit has found little or no overlap between CDIC's Standards and OSFI Guidelines. The Policy paper is addressing the issue by streamlining and facilitating compliance and increasing coordination between OSFI and CDIC to minimize the reporting burden on institutions.

***Open process for formulating and reporting policy decisions***

23. The conduct of financial policies by OSFI is transparent, with good access by the public to operating procedures and regulations (including access through the internet to some forms for insurance companies). OSFI's new *Supervisory Framework: 1999 and Beyond*, in which the regulatory framework is defined and explained, was distributed widely, and also explained through the periodic stakeholder bulletins and the annual reports. There are also public hearings, and the transcripts are available to the public. Information sharing arrangements, including with foreign bank supervisors, other financial agencies, and a commercial database service, are publicly disclosed. Significant policy changes are announced and explained, and benefit from extensive consultation with the public, and with federally regulated financial institutions in particular. Federal financial statutes are subject to the sunset clause, requiring periodic review of the legislation; the consultation process is strengthened as a result. The annual report and other publications provide information on progress made in achieving OSFI's objectives.

24. **Assessment:** Fully consistent with the Code.

***Public availability of information***

25. A wide array of publications is available through OSFI's public information service, including the annual report, the more informal "OSFI bulletin," and speeches. The annual report contains information on developments in the sector, in particular regulatory trends and developments. Regulations are published in book form and widely available to the public. Information on insurance policy-holder guarantees is available through the industry-backed organizations PACICC and CompCorp. OSFI's role in consumer protection is being transferred to another agency under proposals contained in the Policy paper.

26. **Assessment:** Fully consistent with the Code.

***Accountability and assurances of integrity***

27. The Superintendent has prescribed meetings with the Minister of Finance for accountability purposes; in addition, occasional meetings with parliamentary committees take place upon request. The annual report contains financial statements that cover expenditure

and revenue; OSFI's accounts form part of general government, and a balance sheet is thus not separately available, nor is an independent audit performed. A *Code of Professional Conduct*, currently being revised, is issued to staff upon employment, and available to the public.

28. **Assessment:** Fully consistent with the Code.

## **Securities supervision**

### ***Background and overview***

29. Overall, transparency practices are of high quality.<sup>7</sup> The roles, responsibilities, and objectives of securities commissions are generally clearly defined in legislation; the policy formulation and reporting process is transparent and well developed; information on the relevant policies is widely available; and the level of accountability is high, and the degree of assurance of integrity appropriate. Similarly, the practices involving Self Regulatory Organizations (SROs) are satisfactorily addressed in the Canadian case.

30. Some recent developments have significantly improved certain transparency practices. Most important is the fact that the five largest Securities Regulatory Authorities (SRAs) have achieved self funding status. This change has altered these SRAs accountability patterns. There seems to be much greater awareness that agencies must explain any initiatives they undertake to the public. It has resulted in a more proactive stance towards improving transparency, including through expanded outreach programs.

### ***Clarity of roles, responsibilities, and objectives***

31. The broad objectives—including market stability and fairness—and institutional framework of SRAs are laid down in provincial securities laws, and frequently explained in additional publications, including Statement of Priorities. Rule-making power has only recently made inroads into securities regulation, and is not yet universal.

32. SRO oversight is publicly disclosed, and generally well designed through the recognition process and the associated powers to approve changes in by-laws, which typically are published in the official bulletin. Mutual reliance arrangements are in place between SRAs in case of national SROs.

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<sup>7</sup> The mission discussed transparency practices of financial agencies in the securities sector with the Commission des valeurs mobilières du Québec (CVMQ) and the Ontario Securities Commission. These commissions oversee the activities of the Toronto and Montreal stock exchanges, which together account for the bulk of securities activity in Canada.

33. Securities supervision is the responsibility of provincial authorities, and practices differ across jurisdictions. In addition, there are national SROs, such as IDA and MFDA, whose official status varies across provinces. The informal status of the CSA as an coordinating body of SRAs, and the absence of a formal coordination mechanism with federal regulators are also noted. Moreover, banks are supervised by OSFI on a consolidated basis, while their securities subsidiaries are primarily supervised by the provincial regulators; banks have also increased significantly securities trading on their own account.

34. **Assessment:** Partial consistency with the Code: the complexity of the regulatory structure, including between federal and provincial regulators as well as between provincial regulators and SROs, contributes to a lack of clarity in roles and responsibilities between provincial regulators, and between provincial and federal regulators; these issues call for increasing coordination between federal and provincial levels, and more clarity on which agency will be the lead regulator.

***Open process for formulating and reporting policy decisions***

35. The conduct of financial policies of SRAs is generally transparent, with public disclosure of the regulatory framework, supported by explanations in the Bulletin and other publications. Financial reporting requirements are publicly disclosed, and to a large extent centralized nationally through the CIPF, which operates an early warning system for the benefit of SRAs. The fee structure is also disclosed. Arrangements for the sharing of information, including with OSFI, are made public. Consultation before significant policy changes is standard. Public reporting on achieving SRAs objectives is done through the annual report, as well as through other publications.

36. **Assessment:** Fully consistent with the Code.

***Public availability of information***

37. The recent financial independence of some SRAs has contributed to increased awareness to be more accountable, including through better public availability of information. SRAs generally have public information services, with a large publication program catering both to the general public and the industry. The annual report typically reports on regulatory developments in the industry, and contains balance sheets. In addition to providing written materials, senior officials make regular appearances to explain the SRA's activities. SRAs play a publicly disclosed role in overseeing SRO's arbitration programs, as well as the CIPF consumer protection arrangement.

38. Technology developments have contributed to improved disclosure practices, as availability of information through the internet has expanded greatly, and reduced the marginal cost of disclosure. As a result, websites of regulatory authorities now make public a growing range of information, covering the range from regulations to general information pamphlets.

39. **Assessment:** Fully consistent with the Code.

***Accountability and assurances of integrity***

40. Heads of SRAs are generally available to appear before a designated public authority by the respective securities acts. Financial statements are generally audited by the provincial government auditor; statements are prepared in accordance with GAAP, and include operating expenses and revenues. Standards for the conduct of personal financial affairs of officials and staff are contained in by-laws or special Code of Ethics and publicly disclosed. Legal protections for staff are disclosed in the respective securities acts.

41. **Assessment:** Fully consistent with the Code.

**Payment systems**

***Background and overview***

42. The major payment and clearing systems in Canada are the Large Value Transfer System (LVTS) for large value payments, the Debt Clearing System (DCS) for transactions involving federal government treasury bill and bonds and private sector money market securities (both system being overseen by the Bank of Canada, under the Payment Clearing and Settlement Act of 1996) and the Automated Clearing Settlement System (ACSS) primarily for retail payments.

43. The LVTS and ACSS are operated by a private organization, the Canadian Payments Association (CPA), in accordance with the Canadian Payments Association Act, which came into force in 1980. As of July 28, 1999, the CPA membership consisted of 143 member institutions; the Bank of Canada, 59 chartered banks, 26 credit union centrals and federations, 39 trust, mortgage and loan companies and eighteen other deposit-taking institutions. The retail payments are primarily based on checks even though card-payments are increasing, and some 10 percent of large value payments continues to be paper-based.

44. A conflict of interest may potentially arise due to the fact that the LVTS system is operated through a private organization (the CPA) that is chaired and co-chaired by the BoC which is also the overseer of the system.

***Clarity of roles, responsibilities, and objectives***

45. The PCS Act gives the Bank of Canada explicit and formal responsibility for the oversight of payment and other clearing and settlement systems that could be operated in such a manner as to pose systemic risk and the capacity to conduct oversight activities. In addition, the objectives and framework are explained in speeches, discussion papers, and articles. Although other agencies also play a role in overseeing payment systems, the BoC is responsible under the PCS Act to ensure that appropriate risk containment arrangements are used by clearing and settlement systems which could pose systemic risk. The oversight

responsibility is limited to clearing and settlement systems operated by private self-regulatory organizations, not the organizations themselves.

46. The PCS Act gives the Bank the power to designate, to enter into agreements with clearing houses, to issue directives, to request information, and to audit and inspect clearing houses, among others. By-laws of the CPA are approved by the Federal Cabinet. The PCS Act stipulates that Minister of Finance must be of the opinion that the designation is in the public interest. Also, a directive to a clearing system that is established by statute (e.g., LVTS) must be approved by the Minister.

47. **Assessment:** Fully consistent with the Code. Proposals contained in the Policy paper regarding additional roles for the Department of Finance in designating payment systems should be clearly defined.

#### ***Open process for formulating and reporting decision***

48. Regarding an open process for policy formulation, the BoC has taken the lead—as mandated in the Payment Clearing and Settlement Act—in the policy process leading to the new large-value settlement system LVTS, by issuing a series of discussion papers and guiding the debate on the new system. Also, the BoC has issued and disclosed guidelines on what criteria would be applied for designation, and all designation decisions are published in the Gazette. A thorough consultation process has preceded the introduction of the new framework for oversight of clearing and settlement systems. Currently, progress is reported through speeches by senior officials and the BoC's annual report; however, the BoC is considering preparing a report on its oversight activities. Speeches by senior officials and technical papers—including on the conduct of monetary policy under LVTS—contributed to a broader understanding of the new operating framework.

49. **Assessment:** Fully consistent with the Code.

#### ***Public availability of information on supervision policies***

50. The Bank has published a “Guideline Related to Bank of Canada Oversight Activities under the Payment Clearing and Settlement Act”. It has also spearheaded a discussion on the newly implemented LVTS, including through discussion papers of the Payments System Advisory Committee. Additional information on policy principles has been disclosed through speeches by senior officials of the Bank of Canada.

51. **Assessment:** Fully consistent with the Code.

#### ***Accountability and assurance of integrity***

52. See section on accountability and assurance of integrity under Transparency in Monetary Policies.

53. **Assessment:** Fully consistent with the Code.



## **Deposit insurance**

### ***Background and overview***

54. The Canada Deposit Insurance Corporation (CDIC) is the federal agency created in 1967 by an Act of Parliament for the purpose of protecting depositors against the loss of their deposits placed with banks, trust companies and loan companies, in the event of their failure. CDIC membership is restricted to banks and trust and loan companies (either federally or provincially incorporated). It currently has 111 members. CDIC is an important component of the financial safety net in Canada.

55. The Canada Deposit Insurance Corporation Act (CDIC Act) provides that CDIC be instrumental in the promotion of standards of sound business and financial practices for its member institutions and have a role in the resolution of problem member institutions.

56. CDIC introduced a new risk-based fee structure in March 1999; this was widely disseminated and publicly disclosed. CDIC discloses detailed information on the nature, form and funding of the insurance. Both the CDIC Act and the by-laws are publicly available. In addition, it requires that member institutions make information available for distribution to its clients. CDIC members must have CDIC brochures available explaining coverage, as well as a register that details which products are covered—the latter is now also available through the Internet. CDIC also has toll-free telephone lines for consumer inquiries.

### ***Clarity of roles, responsibilities, and objectives***

57. CDIC's legislated responsibilities are to provide insurance against the loss of part or all of deposits; and to be instrumental in the promotion of standards of sound business and financial practices for member institutions and to promote and otherwise contribute to the stability of the financial system of Canada; both objectives are to be pursued in such a manner so as to minimize the exposure of the Corporation to loss. The authority to conduct financial policies is embedded, among others, in the powers attributed to the CDIC (section 10) and the authority to make by-laws (section 11 (2)). Set out in the CDIC Act and incorporated into the CDIC's mission statement, the broad objective of CDIC are widely disclosed and explained in public.

58. As the deposit insurer, CDIC engages in a broad ranges of activities in order to minimize its exposure to loss, although it has no direct supervisory role in supervising compliance with the applicable financial institutions legislation except for the CDIC Act. CDIC does not typically perform examination of its member institutions and relies on OSFI to provide it with information. Under provisions of the Co-operative Credit Association Act, CDIC is empowered to make short-term loans, for liquidity purposes and on secured basis, to cooperative credit societies and to provincially created corporations that provide or administer stabilization or liquidity funds for the benefits of credit unions and their members.

59. **Assessment:** Fully consistent with the Code. An audit has found little or no overlap between CDIC's Standards and OSFI Guidelines. The Policy paper is addressing the issue by streamlining and facilitating compliance and increasing coordination between OSFI and CDIC to minimize the reporting burden on institutions.

***Open process for formulating and reporting decision***

60. Both the regulatory framework and the operating procedures are readily available to the public, and explained in the Annual Report and information bulletins. Parameters for cooperation are outlined in the Act and in guidelines, e.g., OSFI does the annual inspections on behalf of CDIC. CDIC and OSFI have a Strategic Alliance Agreement that includes information sharing.

61. As a matter of course, any government statute of policy intent is accompanied by a consultation period, and preceded by a broad consultative process. In addition, parliamentary commissions also hold public consultations on legislative initiatives. Regulations also require a consultation process before promulgation. The consultation period is a function of the complexity and degree of controversy surrounding the issue. The recently decided new premium structure is an example of a substantive technical change in the structure of financial regulations.

62. **Assessment:** Fully consistent with the Code.

***Public availability of information on supervision policies***

63. CDIC maintains public information services. CDIC's publication program includes the Annual Report and Corporate Plan (both required by legislation), news releases, information bulletins, brochures and fact sheets. The regulations for financial reporting are disclosed in the by-laws.

64. The Annual Report, which is published on a preannounced schedule, reports on the overall health and risk management of member institutions, as well as on adherence to CDIC standards. It also contains limited aggregate data; however, this information is widely available elsewhere. The financial statements, including operating expenses and revenue in the balance sheet, are part of the Annual Report. In addition, the Annual Report also contains information on recoveries on assets taken over from failed institutions. The Chairperson gives speeches and interviews, and these are released to the public.

65. **Assessment:** Fully consistent with the Code.

***Accountability and assurance of integrity***

66. CDIC is ultimately accountable, through the Minister of Finance, to the Parliament for the conduct of its affairs. To this end, CDIC issues an Annual Report to the Minister of Finance, who then presents the Report to the Parliament. CDIC also completes a Corporate Plan on an annual basis.

67. As a Crown Corporation, the CDIC must disclose audited financial statements; this is done in conjunction with the publication of its Annual Report. The CDIC Act specifies that the auditor is the Auditor General of Canada. The accounting procedures follow Generally Accepted Accounting Practices, which is noted in the Annual Report. The financial statements are audited annually. The financial statements are disclosed within 3 months of the end of the fiscal year.

68. As officials of a Crown Corporation, officials act on behalf of the Government, and are responsible to Government. The Chairman is required to appear before the Minister of Finance by virtue of the Minister's responsibility for the Canadian financial sector. In addition, the Chairperson and other senior officials may be called upon to testify before parliamentary committees on an ad hoc basis.

69. CDIC has conflict of interest guidelines for employees and directors of the Corporation. In addition, the government's ethics councilor reviews all appointments to the CDIC Board of Directors.

70. **Assessment:** Fully consistent with the Code.

Table 1. Canada: Consistency with Code of Good Practices on Transparency

Section	Practice	Monetary Policy			Comments
		FC <sup>1</sup>	BC <sup>2</sup>	NC <sup>3</sup>	
Clarity of roles, responsibilities, and objectives	Objectives, institutional framework, relationship between monetary and fiscal operations, and agency roles are clearly defined	X			Strong "Government Directive" in place specifying conditions for government override on monetary policy decisions is international best practice.
Open process for formulating and reporting policy decisions	Instruments, targets, changes in policy instruments are actively disclosed; reports on progress in achieving objectives are published. Extensive consultation precedes any major modification in policy.	X			The inflation targeting framework places a premium on transparency. Additional measures are being considered to better target different audiences, and update inflation outlook more frequently.
Public availability of information	Canada subscribes to the SDDS and meets its specifications. Balance sheet data—including net borrowing by banks—is available at high frequency. A large public information program is available.	X			
Accountability and assurances of integrity	The Governor consults with the Minister of Finance and appears before a Parliamentary committee. Financial statements, based on GAAP and including income and expenditure statements, are audited by external auditors.	X			Proposed amendments to the Bank of Canada Act will provide protections to staff for actions undertaken in pursuit of activities of the bank.

Banking and Insurance Supervision					
Section	Practice	FC	BC	NC	Comments
Clarity of roles, responsibilities, and objectives	Objectives, institutional framework, relationship between federal financial agencies are generally well defined.		X		Roles and responsibilities related to securities activities of banks, although defined, lack formal coordination mechanism between OSFI and securities regulators.
Open process for formulating and reporting policy decisions	Conduct of policies by OSFI is highly transparent. Significant policy changes are subject to extensive consultation periods. OSFI publishes reports on the achievement of its objectives.	X			Canada's sunset clause in its federal legislation provides regular updating and consultation cycles.
Public availability of information	OSFI reports regularly on regulatory developments in the sector. Applicable texts are easily available, as part of a broad publication program.	X			
Accountability and assurances of integrity	The Superintendent reports to the Minister, and may appear before parliamentary committees. Information on operating expenses and revenue is disclosed. Guidelines covering conduct of personal financial affairs are publicly available.	X			No balance sheets for OSFI are available, since it forms part of general government. OSFI accounts are audited, as other government accounts are, by the Auditor General of Canada.

1/ FC: Fully compliant

2/ BC: Broadly compliant

3/ NC: Non-compliant

Securities <sup>4/</sup>					
Section	Practice	FC	BC	NC	Comments
Clarity of roles, responsibilities, and objectives	Objectives, institutional framework, relationship with other securities regulatory agencies, relationships with self-regulatory organizations (SROs) are generally well defined. SROs play an important role in the securities landscape, and are guided towards good transparency practices through recognition process and approval of by-laws.		X		Rule-making authority has recently been granted to OSC, and is expected shortly for CVMQ. Clarity of roles and responsibilities in the area of securities activities of banks could be strengthened. Excellent working relations exist with other securities regulators, but more formal arrangements, including with OSFI and CSA, may be desirable.
Open process for formulating and reporting policy decisions	Conduct of financial policies is transparent, and significant policy changes are subject to a consultation process	X			
Public availability of information	Securities regulators publish information on developments, including regulatory, in the sector. Public information services are well-developed, and have active outreach efforts.	X			The recent financial independence of some securities regulators has increased the awareness of the need to be more accountable.

Accountability and assurances of integrity	Officials appear before various public authorities. Annual reports contain financial statements, including information on expenditure and revenue, and are audited. Standards for the conduct of personal financial affairs are publicly disclosed.	X			The financial statements of some securities regulators are in accordance with GAAP.
Payment Systems					
Section	Practice	FC	BC	NC	Comments
Clarity of roles, responsibilities, and objectives	The framework for oversight by the BoC is clearly defined in the PCS Act and includes the power to designate systems, request information from and audit clearing houses. The Minister of Finance must also sign off on designation, as well on directives to statutory systems.	X			Proposals contained in the Policy paper regarding additional roles for the Department of Finance should maintain clarity of responsibilities of Bank of Canada and Department of Finance.
Open process for formulating and reporting policy decisions	Designation guidelines have been issued detailing criteria for oversight. Extensive consultation process preceded the introduction of new LVTS.	X			
Public availability of information	See section under Monetary Policy.	X			
Accountability and assurances of integrity	See section under Monetary Policy.	X			

4/ This section relates to the transparency practices of the OSC and the CVMQ.

Deposit Insurance					
Section	Practice	FC	BC	NC	Comments
Clarity of roles, responsibilities, and objectives	Objectives, institutional framework, relationship with other financial agencies (OSFI, Bank of Canada, Department of Finance), clearly defined.	X			
Open process for formulating and reporting policy decisions	Conduct of policies is transparent. Consultation periods are observed before significant changes. Reporting on how objectives are achieved in context of annual report.	X			
Public availability of information	CDIC reports on major developments, including on market transactions (e.g. recoveries on assets) and emergency support. There is a public information service that issues various publications, including information on the nature and form of the guarantee arrangement, its financing and its operating procedures.	X			
Accountability and assurances of integrity	Officials are responsible to and appear before the Minister of Finance. The financial statements published in the annual report are audited by the Auditor General of Canada; accounting policies follow GAAP.	X			

