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Chair

Mr. Massimo Pacetti

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● (1110)

[*English*]

The Chair (Mr. Massimo Pacetti (Saint-Léonard—Saint-Michel, Lib.)): We will begin. Good morning, everybody.

Monsieur Le Pan and Ms. Pasteris, welcome.

I want to thank everybody for coming. We're here pursuant to Standing Order 32(5), the annual report of the Office of the Superintendent of Financial Institutions, the main estimates, and part III of the report on plans and priorities of the Office of the Superintendent of Financial Institutions.

Mr. Le Pan, I can allow you to give us a small introduction of the three areas. I'll leave it to your discretion as to how you want to allocate your time—about 15 minutes is sufficient—and then we'll allow the members to ask questions. I'd like to finish about 12:45 p. m. or 12:50 p.m., because then we'll have to vote on the main estimates. I think we'll have plenty of time, from what I understand—unless John gets talking.

Mr. Le Pan.

Mr. Nicholas Le Pan (Superintendent of Financial Institutions, Office of the Superintendent of Financial Institutions Canada): Thank you.

I did send over a copy of an opening statement, and I think it has been distributed. I assume people have the part IIIs. We also brought copies of our annual report, and I think those have also been distributed. I'll refer to those in a minute. We probably need to make sure people have a copy of those.

In terms of my statement, I'd like to take it as read, but then provide a number of highlights, Mr. Chair, and then talk about a couple of key things in the estimates and in our annual report.

The first point I want to talk about is our mandate. We've had a legislated mandate at OSFI since 1996. The key elements of that mandate are as follows:

The first is to supervise institutions and federally regulated pension plans to determine whether they're insound financial condition and meeting their minimum funding requirements, and are complying with their governing laws and our supervisory requirements.

Second, we have an explicit responsibility to promptly advise institutions and pension plans in the event there are material deficiencies, andto take, ourselves—or require management, boards of directors, or plan administrators to take—necessary corrective measures.

Third, we explicitly have a mandate to advance and administer a regulatory framework—that's our framework of rules and guidance—that promotes policies and procedures designed to control and manage risk in institutions.

Last, we have a role in monitoring and evaluating system-wide or sectoral issues that may impact negatively on financial institutions.

Our legislative mandate from Parliament requires that we have due regard for the need to allow institutionsto compete effectively and for them to take reasonable risks. Our mandate explicitly recognizes that management, boardsof directors, and pension plan administrators are the ones who are ultimately responsible—not us—for what goes on in these organizations, and that as a result, it is possible that financial institutions and pension plans can fail or need to be restructured.

Our role, in essence, is to safeguard people's savings through contributing to ahealthy, safe, and sound financial sector. We do this by having effective processes forevaluating risks to financial institutions and pension plans and by evaluating those institutions' capabilities to measure and manage those risks. That's a key important point, Mr. Chair, because it's not the existence of risk; it's risk relative to the institution's capability to measure, manage, and monitor it. Some institutions may choose higher-risk strategies, some lower-risk strategies. What we care about is whether their capability to measure, manage, and monitor those risks is commensurate with the risks they're taking. If there's a material imbalance, that's when we have the specific mandate and authority to act.

We promote sound business and financial practices. That's, in part, through promoting guidance and rules, some of it developed here in Canada and some of it developed elsewhere, internationally. It's key to our effectiveness that we have the capacity and the willingness and the powers we do under the relevant legislation to intervene early on, to avoid or minimize potential problems.

The report on plans and priorities provides parliamentarians and the public with aconcise summary of our operations. We talk a bit in there about the anticipated changes in the environment in whichwe operate, and we state the priorities we intend to pursue over the next three years. You'll find there, with respect to the environment, discussions of some of the changes going on in the various parts of the financial sector that we regulate—changes in the environment affecting banks, life insurance companies, and the property and casualty industry.

There are also statements of a number of factors important in the economic and financial environment of the private pension plans we regulate. For example, we've recently seen excellent credit quality, and credit is one of the major risks we worry about when it comes to financial institutions.

At the same time, operational risk has been increasingly an issue that regulators have been focusing on in institutions. Market risk is one of the risks that we consider. Canadian banks are not major takers of market risk, but there are some aggressive ones here. It varies institution by institution. The amount and importance of market risk can be determined a lot by the complexity of the products that institutions are using, either to manage their own risks or to deal with counterparts in the marketplace.

The property and casualty industry went through a period of significantly reduced profitability for a number of years. Some of that was due to developments in the marketplace—claims generally exceeding premium revenue, lower investment returns. There has recently been a significant rebound in profitability in the property and casualty industry. But we need to remember that this is a very cyclical industry, so the average profitability in that industry is still only about 8% over the past three or four years, as a return on equity. In part because of the significant erosion of profitability in the industry, we saw capital levels declining, getting much more close to the levels where we needed to act. The number of potential problems that we had in this industry rose, as we say in our report on plans and priorities as well as in our annual report.

With the restoration of profitability and a number of actions on the part of insurers and policy-makers, the number of problems in the property and casualty industry is dropping significantly.

We regulate about 10% of the private pension plans in Canada. The rest are regulated provincially. We have seen a significant increase over the last several years in the number of pension plans on our watch list. Primarily, though not exclusively, these are defined-benefit pension plans. In our report on plans and priorities, and also in our annual report, we cite the number of pension plans on our so-called watch list. It's currently running around 80 of the roughly 300 defined-benefit pension plans, defined-contribution pension plans, that we regulate and supervise.

That number has come down a little bit, but it's relatively stable. It's hasn't come down a lot. It's hasn't come down the same as the number of problems in the property and casualty industry. We point out in our material on the environment that what's key to the financial position of defined-benefit pension plans is a combination of three things. It relates, first of all, to what's happening in asset markets, equity markets, for their investments. We've seen some rebound in this area over the past year. Second, it has to do with what happens to long-term interest rates, and I'd emphasize *long-term* interest rates. We've seen a decline in long-term interest rates over the last couple of years that has raised the value of pension plans' liabilities. If you have equity markets that have come down a bit or have been weak, and you have liabilities going up, it's no surprise that we've had an increase in the number of solvency problems.

The third thing, however, that is equally important is the financial position of sponsoring organizations. The most difficult problems we deal with happen when there's a deficit in the pension plan, together with problems in the sponsoring organization's business. In these cases, the sponsoring organization has less capability to fund the deficits in the pension plans.

I've described the situation—and we describe it in our annual report in the pension plan area—as stable, manageable, but fragile. Major changes in either asset markets or long-term interest rates in the wrong direction could increase the number of difficulties we're dealing with. But we are seeing, and we report on, material progress in dealing with problems in the pension area.

We also describe in our annual report several of the other activities we engage in. We describe what's happened with the number of problem organizations we're dealing with. We describe some of the major initiatives on the rule-making side, which are also referred to in our report on plans and priorities.

Some of the rule-making initiatives we participate in occur internationally. There's increased development of harmonized rules for internationally active banks and insurance companies, some of which are domestic.

We also have a relatively small but important program of international assistance, paid for by CIDA, in support of the government's initiatives to assist emerging market economies in building their capacity for regulation and supervision of financial institutions. In the report, there's material on the range of countries we deal with.

● (1115)

The main estimates and the report on plans and priorities contain information, either in the summary in the first few pages of the report on plans and priorities, or in the main estimates themselves, of our forecast spending.

● (1120)

The Chair: May I interrupt before we go to the estimates? There's something that troubled me. Is the rate of return on the property and casualty insurance companies something you regulate or you determine?

Mr. Nicholas Le Pan: No.

The Chair: You were saying it's reasonable over a five-year period.

Mr. Nicholas Le Pan: We don't regulate the returns in any of the industries we regulate and supervise, but the profitability of the sectors and the institutions we regulate and supervise is absolutely key to their safety and soundness. If an organization doesn't have sustained profitability, it's not going to be safe and sound for very long. That's one of the areas of the environment out there and something we try to keep tabs on, trying to determine whether things are moving in the right direction from our perspective or the wrong direction. The changes in returns in the property and casualty industry have been one of the biggest things that have happened in the environment over the last two years. It's affected our operations.

When we had a sustained period of three or four years of poor returns, we reallocated resources in a major kind of way internally to deal with the number of increased problems we had, and we reported in our annual report—there's a chart in there—the number of problems we had of so-called “problem institutions”. It went way up in the property and casualty area.

That's the sense, Mr. Chairman, in which I was referring to that. It's a key element of our environment. Returns in the banking industry, returns in the life insurance industry have generally been pretty good and don't vary as much as they do in the property and casualty insurance.

The Chair: Thank you.

Mr. Nicholas Le Pan: We're forecasting planned spending in the main estimates of approximately $83.9 million for the 2005-06 period, and we expect our main estimates spending will fall slightly in the following year to about $82.7 million.

I'd like to emphasize, Mr. Chairman, that virtually all of our costs.... You can see this in a variety of places. In the report on plans and priorities, for example, page 10 of the summary has financial resources. You can see the $83.9 million and the $82.7 million right at the very top of page 10—or in the actual main estimates themselves; the numbers are in there as well.

I want to emphasize that all of OSFI's costs, except for a very small amount related to the operations of the office of the chief actuary, are paid by the institutions and pension plans we regulate and supervise. As a result, what you'll see is that the net costs of OSFI's operations in the main estimates are less than a million dollars, because we're recovering costs from insurance companies, banks, and pension plans, and the chief actuary's office is also recovering costs from the client departments for which he does work —for example, the Canada Pension Plan, work done for HRDC and the Department of Finance, and so forth. Again, you'll see that shown in tables in the documents.

If you look, for example, at pages 43, 44, and 45 of the report on plans and priorities, on pages 43 and 44 you will see our sources of revenue coming from assessments, user fees, and charges for approvals, for example. International assistance I mentioned, where we charge the costs of large parts of it to CIDA, and so on.

So the spendable revenue is significant relative to costs. You see, for example, the total of about $82 million or $83 million at the bottom of page 44. Over on page 45 of the report on plans and priorities you'll see table 5, the net costs of the agency for the estimates years. It's around $500,000—actually $533,000—in table 5. All of this relates to some functions of the office of the chief actuary that are not charged directly to client departments.

Our approach in management of our budget internally at OSFI is to ensure that we are allocating resources to higher-risk areas, and recently we've been making significant strategic investments related to process improvements in our operations. As I mentioned, in the past couple of years we increased our resource commitment related to supervision of the property and casualty sector, but because of the improvement in results, we reallocated resources accordingly.

● (1125)

Several years ago the resources we devoted to pensions were much less than they are today—20%, roughly, less than today—and they have increased to roughly the $4 million level out of our total costs. If you look in the estimates, page 10, for example, shows a breakdown of our planned spending by major areas, and at the bottom of that page you'll see the amount we spent on pensions.

Some of those investments that I talked about also have impacts on the trends in our main estimates numbers. We've engaged in material capital projects to invest in technology in order to enhance our supervisory processes, and some of those projects are winding down. That's reflected in the main estimates and the report on plans and priorities and is one of the reasons why there is basically no increase in our budget, in main estimates terms, from last year to this current year; however, those process improvements will have an ongoing beneficial impact on the costs we assess to our regulated financial institutions and pension plans.

We note in our report on plans and priorities, and also in our annual report in the introduction and in the environment, that changes in government policy also shape our environment.

In particular, let me refer briefly to the recent budget announcement related to reducing overlap and duplication between OSFI and the Canada Deposit Insurance Corporation, CDIC. That is designed to reduce the overlap and duplication in rules, and also the duplication in processes for approving new bank applications. Those changes will have, I believe, material impacts on compliance costs of financial institutions. Those changes will not have any significant impact on OSFI's direct costs.

There's a third part of that announcement, however, in which the two organizations, OSFI and CDIC, are now engaged in a process to review certain administrative and corporate services functions. Donna Pasteris, who heads my corporate services sector, is here with me and can talk more in detail about those if the committee wishes.

We're looking at the fact that we're both running IT systems, both running wide-area networks, both running certain processes for assessing institutions' transactions, and we think there are some opportunities for streamlining there that will have resource implications. Though those are not reflected, of course, in the main estimates at this point, we have been tasked to develop a joint plan on this for the government, which we will do by June. By the time we get to June, we'll have a better idea of the magnitude of savings involved.

Obviously, compliance costs are an important issue that we worry about, though we have to recognize that we are in the business of regulating and supervising, and sometimes, therefore, we are going to do things that institutions would wish we didn't. But that's part of the job we're in, quite frankly: when there are material deficiencies, to make sure they get dealt with.

A good example, however, of the kind of ongoing initiatives we do, as referred to my in opening statement, is a joint effort we put together with provincial regulators as a result of our reviewing our supervisory processes. In reviewing our supervisory processes, starting initially with the insurance industry, we then looked at what data requirements we had and looked to the data we were getting, because many of those requirements had been set a number of years ago.

Together with the provinces, after reviewing those processes, we reduced by up to half the amount of data that would be filed by a typical insurance company. We're engaged in a similar process in the banking industry, where I suspect the amount of reduction in data requirements and therefore compliance costs to industry won't be quite as big, because that data was reviewed more recently than in the insurance area; it was reviewed about seven or eight years ago. But I still expect that, net, we'll be able to reduce data requirements for filing for institutions as a result of these kinds of initiatives.

One of the other things that's covered in our annual report, but also in the report on plans and priorities, is our accountability framework. I mentioned our mandate. We have a number of processes in place that help us determine how we're doing.

● (1130)

From time to time the International Monetary Fund and the World Bank engage in what's called a financial sector assessment program of countries. Canada was one of the first countries to go through such a process back in 2000, and we'll be part of an abbreviated update review in the near future, I believe early in 2006.

Those reviews are basically designed to determine whether regulators are living up to internationally established principles for effective financial regulation. The last report on Canada concluded that a “high degree of compliance with international standards and codes has contributed to a stable financial system”. I may say, Mr. Chairman, that's also been emphasized by rating agencies that take into account the regulatory environment in their assessment of the Canadian scene.

We conduct anonymous surveys of knowledgeable observers of our operations and get feedback on our activities, such as our approvals process and so on, by asking questions about our overall operations, including how we compare to others. The results have generally been good, but from time to time the observers identify areas where we can continue to improve, because the environment we regulate and supervise is dynamic; it doesn't stand still, and neither can we.

We posted the results of our most recent industry consultation findings on our website on April 12 and will post further survey results as we get them.

We publish, of course, our annual reports and financial statements. Our financial statements are audited annually by the Auditor General, and they're prepared according to Canadian generally accepted accounting principles. The Auditor General audits annually our financial statements and related control processes, and the report on plans and priorities also contains information on various performance measures we've put in place.

Those are the highlights, Mr. Chairman.

I'd be happy now to take questions on anything related to our operations the committee would like to hear about.

The Chair: Thank you, Mr. Le Pan.

We'll do a seven-minute round.

Mr. Penson.

Mr. Charlie Penson (Peace River, CPC): Thank you, Mr. Chair.

I'd like to welcome our witnesses here this morning from the Office of the Superintendent of Financial Institutions.

I'm interested in the bank merger issue, as to what role your office plays in that and what the latest vibes are you're getting out of government on where that issue is going. It would have a big impact, I would expect, on your organization, Mr. Le Pan, if the banks were allowed to merge. I would be interested to hear any information you could give us on where that issue is and what role you would play in that in terms of advice to the government .

Mr. Nicholas Le Pan: Thank you.

We have a very specific and pretty well-defined role, one understood by the potential participants in the process. Our job would be to assess the impact of a particular transaction on the risks to the safety and soundness of the merged institutions. In order to do that, we would look at everything related to the impact on the financial position of the entity, the capital position of the entity and so on, which would depend on the nature of the transaction and how it's financed.

We would look at integration plans, impact on risk control functions, and all of those sorts of things. We would look at the ability of an organization to have a sensible plan to deal with some of the well-known pitfalls around integrating and merging large organizations. We all know some of these kinds of transactions have been successes and some have not been successes in other jurisdictions, and we would question the organizations and look to see what plans they had. Ultimately, we would make a recommendation based on our assessment of the impact on risks in safety and soundness, i.e. based on our mandate.

In addition to our role, there are the roles of others, of the Competition Bureau, of the government itself, and of Parliament with respect to public interest issues. We would be one leg, if you will, of the review process, and we would make a recommendation. If there were certain aspects of a proposed transaction we believed weren't satisfactory from a safety and soundness perspective, before we were prepared to make a recommendation we would want to make sure those aspects were dealt with in some fashion that was appropriate, through either changes in the transaction or in the nature of the operations or undertakings and so on.

● (1135)

Mr. Charlie Penson: Mr. Le Pan, a lot of people think this is a new issue, yet there have been mergers in the banking industry before, although it takes me back a while. Do you have any sort of historical studies that have been done to assess the results of the mergers that took place in the past, and do you also look at issues like the issue of the credit unions, which are waiting in the wings to be able to compete? Although I know they're not under your supervision at the moment, I would think they would have to be if they were to expand and try to fill that gap. Can you help us out there?

Mr. Nicholas Le Pan: First of all, we do have experience in assessing large transactions, and a number of large transactions have occurred in the Canadian financial system over the past couple of years. Some of them involved significant acquisitions by Canadian institutions—

Mr. Charlie Penson: Like the life insurance—

Mr. Nicholas Le Pan: Exactly. We're in pretty good shape to perform the role I described, so I don't believe there's a big impact on our operations. Obviously, depending on what happened in the risk assessment of the organization, we would allocate resources for ongoing supervision.

In terms of the question you asked about historical studies, there haven't been major bank mergers, for example, in Canada for quite a long period of time, so we do not have specific studies of the impact of those—the ones that occurred historically, many years ago—that I believe are relevant to the discussion today. There certainly is experience from a variety of perspectives, in other jurisdictions, of major transactions, and we've had major transactions in Canada, many of which, if not all of which, have essentially worked out. That's the kind of environment that we look at.

With respect to credit unions, we do not have the mandate or authority with respect to regulation of the credit unions other than with respect to certain of the credit union centrals. Unless that mandate was changed, the credit unions I'm aware of said they might acquire, for example, more activities coming out of a merger and all that kind of stuff. Fine, but that's not something we would get involved in.

Mr. Charlie Penson: Mr. Le Pan, in the normal course of actions, would you look at mergers that have taken place in the banking industry in other countries in order to have some sort of database or assessment of how it might work in Canada? Have you looked at that?

Mr. Nicholas Le Pan: We did in 1998 when the original mergers were proposed, and we have also updated that intelligence, if you will, from time to time.

My conclusion from that is that it's very difficult to make a generalization. It depends very much on the specifics of individual transactions. So the success factors and how they're dealt with in individual transactions, I believe, are hugely important. That's why we approach this on a case-by-case basis. Should they be allowed? I'm not in a position to make a general conclusion either for or against, because so much depends on how the individual transaction—

Mr. Charlie Penson: Can I ask you then, Mr. Le Pan, if the Minister of Finance were considering allowing the mergers to happen, in the normal course of action would they ask you for some risk assessment of potential mergers?

Mr. Nicholas Le Pan: As I've said, our assessment would be on a case-by-case basis. We have a specific role in the process.

Mr. Charlie Penson: You would have to have an application first.

Mr. Nicholas Le Pan: Yes. If I were asked by someone today what I thought about the impact of mergers, I'd say exactly the same thing as I just said to you about risk. It depends so much on the individual case. And that's what I say every time I get asked this question, because I don't believe you can make generalizations about the impact, for or against, on risk. You have to look at individual cases.

Mr. Charlie Penson: In order for the Minister of Finance to decide on a policy of whether he's going to approve a merger process, they have to have some risk assessment, I would think, of what the potential is. Isn't your work sort of after the fact? You'd have to make that decision before any companies would be allowed to make the application.

Mr. Nicholas Le Pan: Effectively, I'm also saying that you can't make a case either for or against based on generalizations of risk. It's going to depend. I don't believe that risk in the system, by itself, is enough of an issue to decide one way or the other on the general policy. And that's what I would say to anybody, and that's what I've said, and we still testified for I don't know how many years.

I think that's the experience and what the experience shows in other countries. Risk is not an issue, either to allow it or not to allow it. Those decisions should be taken on other grounds.

The Chair: Thank you.

If I may, maybe I can help Mr. Penson. He wants to be asked directly. So if I were to ask you if the Bank of Montreal were to merge with, let's say, CIBC—let's name them—what would be the risk factor?

Mr. Nicholas Le Pan: I can't answer that. First of all, Mr. Chair, I'm not going to answer a hypothetical. Second, in any hypothetical, as I said earlier, it's going to depend on how it's done, how it's executed, and all those kinds of things.

The Chair: They almost merged.

● (1140)

Mr. Nicholas Le Pan: My advice on this is something.... I'm not going to be in the position of revealing whatever confidential material I might get, in the case of an actual merger, about what the plans were.

The Chair: Next is Monsieur Côté; then I have Mr. Bell.

[*Translation*]

Mr. Guy Côté (Portneuf—Jacques-Cartier, BQ): Thank you very much, Mr. Chairman.

Thank you for your presentation, Mr. Le Pan and Ms. Pasteris. If I understood correctly, if, hypothetically, two banks were considering a merger, you would be asked for your advice. Is that correct? That's extraordinary.

I will go on another subject because some of my questions have been stolen from me. In your annual report, you mention that you have continued with a program of assessment to determine the progress federally regulated financial institutions have made in developing anti-money laundering and anti-terrorist financing programs. A few weeks ago, this committee has heard representatives from FINTRAC—CANAFE in French—who presented their report to us. Is there any cooperation between your two organizations? I suppose that you are working together. How is this cooperation taking place?

Mr. Nicholas Le Pan: Yes, there is a cooperation program. The roles of the two organizations are somewhat different, but we do cooperate rather closely.

We at OSFI are not responsible for what is going on in individual transactions. It is FINTRAC that is responsible to receive from institutions the reports on transactions, statements about dubious transactions, etc. It is up to them to examine these and try and find any patterns and to have good working relationships with the RCMP, the CSIS, etc. We are not responsible for this.

We do a lot of work on the issues of quality, of risk management related to credit or to transactions such as those that you have mentioned. We deal with the quality of compliance systems, etc. It is indeed somewhat top down. We have enacted some rules, such as *Know your customer*. This is of general application, for example in a large bank. We do some analysis here and there to know what is going on, to check whether policies are well managed in an institution. In fact, in any large organization, it is quite a challenge to have all the information. In all cases that we are dealing with, whenever there are significant deficiencies, it is up to us to exert some pressures for the problems to be dealt with.

That is our role. Thanks to an amendment to the legislation, we are now able to share the information with FINTRAC. They are very interested in the quality of compliance systems. For our part, we are interested in knowing whether they have found any systemic problems in an institution. These are the highlights of our system of cooperation.

I believe that, fittingly and in spite of very close relationships between our two teams, it is now working quite well.

Mr. Guy Côté: Unfortunately, as is often the case, the people who wish to circumvent the law will always find a way to do so. At this time, do you have any suggestion to improve the situation and make sure that this does not happen or to reduce the frequency of it happening? Is there anything that comes to your mind that would facilitate not only the follow-up on these amounts, but also eventually the recovery and all that follows?

Mr. Nicholas Le Pan: I have no solution as such. However, what is very important for us is to focus on our mandate. As I just said, there are challenges here and there. It is difficult for large institutions to always have the data required to fully understand the situation. Our role is to identify once and a while the deficiencies, the problems, and to make sure that it is being dealt with.

For example, last year we identified the issue of mortgage brokers. They do not always have all the data required to comply with the *Know your customer* rules. We have made a study, we gave the results to institutions and we have identified those that are more closely involved with mortgage brokers. We want to make sure that everything is fine. That is our role. It is not to have a comprehensive view of the situation. We have a rather important role to play. I believe that for us, at OSFI, it is very important to focus on this.

● (1145)

Mr. Guy Côté: Are your recommendations in various areas rather of a coercive nature or do they go beyond mere advice and is their implementation mandatory?

Mr. Nicholas Le Pan: It can be either, depending on the situation. Under the legislation, we do have the rather extended power of issuing mandatory orders; once in a while, but rarely, it is essential to do so. Everyone knows that we do have that power and so we do not need to always make use of it. Once in a while, we do have requirements and we also make recommendations. In any significant case, we always issue requirements. One of our tasks is to give good feedback to financial institutions and this could be called our added value.

[*English*]

The Chair: Next are Mr. Bell, Ms. Wasylycia-Leis, Mr. Pallister, Mr. Hubbard, Mr. Harris, and Ms. Minna.

Mr. Don Bell (North Vancouver, Lib.): Thank you.

Welcome.

I have to jump around a little bit. Some of my questions have been asked already. But I noticed you talked about student loans in your report. You make reference to completing the second actuarial review of the Canada student loans program. Were there any particular concerns you identified with respect to it?

Mr. Nicholas Le Pan: Before I respond to this question, I want to be very clear about how this part of the operation of the office works, because it's hugely important and has been the subject of quite a bit of discussion from time to time, including within parliamentary committees. The office of the chief actuary is part of my office, but according to the accountability framework I've set up, the chief actuary is responsible himself for any of the actuarial judgments and is responsible to the client departments. I am not. I'm responsible for the money and the administrative services and so on, but I'm not responsible for the details of the actuarial judgments, and that's hugely important in terms of the independence of those judgments.

On your question—broadly speaking, I'm not aware of any. The reports are published as they're done. They're not aware of any problems there, as Jean-Claude Ménard, the chief actuary, has confirmed to me. As I say, the reports are public; when the next one is done, it will also be published.

Many of these reports, as is the case with the Canada Pension Plan, are actually peer reviewed. That's something I spent a lot of time putting in place. We've actually put in place some important peer review processes to ensure there's high quality in those reports. I think it's important in the accountability framework.

That's the answer to your general question. If the committee wants to get involved in more details, I suggest we get the client departments back, together with the office of the chief actuary, and go through some of the details on how the programs are running.

● (1150)

The Chair: But you do review his assumptions, or the way he—

Mr. Nicholas Le Pan: No. I do not. In fact, part of the set-up we've got here is that his assumptions for major programs are developed in consultation with the users, in consultation with independent experts. For example, demographic assumptions, rate of return assumptions, and things like that are developed in conjunction with the relevant parties, but OSFI and I do not review his assumptions. Those are his decisions to make. They're done according to the standards of the Canadian Institute of Actuaries, and they're reviewed by either the Auditor General, for some of the reports on public pension plans or employee pension plans, or by a peer review process with respect to something like the Canada Pension Plan. Those peer reviews, which explicitly look at the assumptions, are published, and there'll be one coming on the Canada Pension Plan—it's not quite finished yet, but it will be published soon.

Mr. Don Bell: Okay. I'll ask my questions so you can take note.

One—on the Air Canada pension plan, the deficiency was $1.3 billion, you say, which represented 13% of the liabilities. They asked for this change to be able to fund those solvency deficiencies over ten years rather than five years. Was that done? Do you have any comment on that?

I'll jump to my next question, if you'll take note. I know the guarantee from CDIC, the other body you're talking about integrating, was increased, I think, from $60,000 to $100,000. When was the last bankruptcy in that financial institution? In order words, what is the risk? How long ago was that?

I had a question on your report; I'm jumping from the two different ones. You say priority number three is a “prudentially effective, balanced and responsive approvals process”, and there's a reference somewhere else to “non-prudential regulators”. That's a term I...does it relate to the term “prudent”? It says, “This has led to growing attention by non-prudential regulators....” Can you clarify that for me?

Mr. Nicholas Le Pan: On the first question, the Air Canada pension plan, as part of its restructuring the company asked that it be allowed to fund its deficit over ten years rather than the normal five. I was prepared, after significant discussions, to recommend that to the government because it required a change in regulations. I was prepared to recommend that because I believed that even though an extension might pose some risks, it was better for the pensioners than the alternative of terminating the plan. I believed there were adequate conditions, as part of the extension, to reduce risks to a reasonable level.

I wanted to make sure, for example, the funding was not all back-end loaded, and a significant amount of it had to occur in the first five years. I wanted to ensure there was an adequate process of disclosure to plan members and their representatives; an adequate process for them to be able to buy in through their representatives, or directly for plan members and pensioners; and protection from downside risk should there be further problems down the road.

Based on that, I recommended to the minister two things. First, I recommended that the regulations be changed to allow Air Canada to fund that deficit over 10 years, and that was done. Second, I recommended that consideration be given to allowing similar relief for companies also in CCAA restructuring; that they be provided with similar kinds of conditions, as had occurred in the Air Canada case.

The regulations to do that are in process but have not yet been promulgated to make them more general, but the regulation for Air Canada was processed and is in place.

I may get these in a different order.

On non-prudential regulators, the way I look at things, there are regulators like OSFI whose focus is safety and soundness, and there are regulators that deal with more market conduct issues. Securities regulators, certain provincial insurance regulators, and so on, deal with the conduct of business, how clients are treated individually, insider trading rules, and that kind of stuff. By “non-prudential”, I don't mean they are somehow unsafe; I mean they're focusing on market conduct issues rather than safety and soundness issues.

There was one other question I should have written down but I didn't.

Mr. Don Bell: It had to do with the bankruptcies of financial institutions.

Mr. Nicholas Le Pan: Yes. The last deposit-taking institution failure federally was in 1995 or 1996.

● (1155)

Mr. Guy Côté: In Alberta.

Mr. Nicholas Le Pan: It might have been in Alberta. It was the Security Home Mortgage Corporation, as I recollect.

Over the past few years, the problems we have dealt with that have led to closures have been in the property and casualty industry, and they have been almost exclusively Canadian operations of foreign insurers. We report on these in our annual report as they occur. So there were two in 2001, and one in 2003. It was Home Insurance Company in 2003, Reliance Insurance Company in 2001, and Alta Surety Company. They were all small property and casualty companies. We had taken previous action to freeze assets in Canada and require the company generally to maintain assets larger than their Canadian liabilities. But there were problems abroad in the ability of the parent companies to support their operations. The losses have not been fully worked out, but they are going to be non-existent or minimal.

But we haven't had a deposit-taking institution failure federally since 1995 or 1996.

Mr. Don Bell: There's one definition I'd like to get. In your report you refer to the costs and your revenues for your department, and you state that your surcharges to the problem institutions were 38% higher than estimates due to a greater number of the staged institutions and longer periods of staging. Can you clarify what “staged” means?

Mr. Nicholas Le Pan: Look on page 27 of the annual report, where it says “intervention ratings”. An institution is assigned an intervention rating, which is described in our so-called guide to intervention, which is public and has been for many years. So normal is an unstaged institution, and an early warning is stage one. Most of our problems are early warnings, and then they get better and are taken off the list.

Mr. Don Bell: Stage four is insolvency.

Mr. Nicholas Le Pan: Yes.

Mr. Don Bell: I understand that, thank you.

Mr. Nicholas Le Pan: Thank you.

The Chair: Thank you, Mr.Bell.

I have Ms. Wasylycia-Leis for seven minutes. Then we start the five-minute rounds with Mr. Pallister, Mr. Hubbard, Mr. Harris, and Ms. Minna.

Ms. Judy Wasylycia-Leis (Winnipeg North, NDP): Thank you, Mr. Chairperson.

Thank you, Mr. Le Pan, for your presentation.

I want to focus in on pension governance, which is part of the mandate of the office that you are in charge of. I want to get right to a controversial issue and give you a chance to answer some long-standing questions around the question of the state of the pensions owing to Voyageur employees in the case of the 1997 investigation.

I think a cloud still hangs over your head about that whole issue. In fact, those employees involved never felt that justice was done and they had to go to the great length of launching a lawsuit. I don't believe this issue is mentioned in the annual report, and I'm surprised it isn't, and I'd like to know why. Your office and you were heavily involved in the investigation of the Voyageur company, which was, as we all know, owned in part by our Prime Minister, Paul Martin, at the time. There were great concerns about the treatment of the 140 employees in terms of their pensions, since many of them, as a result of this whole sad chapter, lost as much as 30% of their pensions.

In that whole episode, questions were raised about direct contact between the Prime Minister's Office and you. The news reports all indicate that you had direct contact with Terrie O'Leary. There were questions made about why you did an audit and then did not proceed with any investigation, why apparently some documents were shredded, why the study by Price Waterhouse was changed, and why you didn't do a full investigation into this sad chapter, this sad state of affairs, when this in fact is your mandate—pension governance and the whole issue of protection of pensions when companies change hands or become bankrupt.

These are workers who lost life savings, and many of them are destitute. I'd like a chance for you to clarify what happened and to try to clear up what is considered still a very controversial issue.

● (1200)

Mr. Nicholas Le Pan: Mr. Chairman, I'm really here to talk about our estimates or annual report. The issues that have been raised really aren't part of this kind of stuff, but I'd be happy to make a couple of comments.

I've been extensively on the public record about what happened here. I really don't have much to add to that. The reality, as I've said earlier, is that it is not possible—and our mandate recognizes this—to avoid the need to restructure pension plans from time to time. In some cases there will be circumstances in which the pension plans have to be restructured and there are not sufficient assets to cover all the liabilities. This was unfortunately one of those.

I totally agree, Ms. Wasylycia-Leis, that it is very unfortunate when that happens. We do take action to reduce the likelihood of that happening, prevent the losses as much as possible, and reduce them, but we cannot guarantee against there being problems in plans. We do post mortems on that. That's one of the things we look at, and that's part of some of the reports you referred to.

We also take our responsibilities very seriously to make sure the ministers we report to are informed—not to influence our decisions but are informed in this case, as I've so testified and as I've so indicated in public material—after the decisions were taken, so that we do have a relationship through ministers with Parliament.

I don't really have anything more, Mr. Chair, to add to the details of what's already on the record.

The Chair: If I may, you asked why it was not included in the annual report. I think that's really the only relevant point in the preamble. Perhaps we can address that particular point.

Mr. Nicholas Le Pan: Because it was not part of this year. We're talking about events that occurred—

The Chair: Seven years ago, right?

Ms. Judy Wasylycia-Leis: That may be true, Mr. Chairperson, but it's also true that it was in 2003 that in fact past employees of Paul Martin's bus company actually asked the federal pension watchdog, Mr. Le Pan, to reopen the investigation. They've outlined serious conflict of interest concerns that have never been addressed, as far as I can tell. I think the fact that the Prime Minister's staff were in touch with Mr. Le Pan or his staff raises all kinds of questions about whether or not a proper investigation was done.

I think it's an ongoing issue. It's still before this office. It still should be part of our discussions. I think we need some explanation as to whether or not a thorough investigation was done. Why, when it was requested and these concerns were raised, wasn't there a further study done? Why did these workers have to go to the nth degree of launching a lawsuit and trying to seek justice that way?

The Chair: If I may, this is a case from seven years ago. If it were in the annual report, I would not hesitate to have Mr. Le Pan answer, but we can't go back seven years.

Ms. Judy Wasylycia-Leis: I'm not going back seven years; I'm going back to 2003.

The Chair: It's not in the report, and the report has been audited, so unless there's a—

Ms. Judy Wasylycia-Leis: No, but it should be, and I think the question is—

The Chair: Unless you're referring to the fact that it's a specific omission, or if Mr. Le Pan would like to—

Ms. Judy Wasylycia-Leis: Yes, I think there is an omission. I think it's an ongoing concern. It should be listed.

The Chair: Do you want to...?

Mr. Nicholas Le Pan: I'd just say that our responses to the issues that were raised in 2003 are a matter of public record. We do not put every transaction-type issue in this report. We do, as I said earlier, when there is a failure of an institution or when there is a plan that needs to be restructured. In the year that occurs—which was not 2003 for this case—we would put that in our annual report, and we will continue to do that.

Ms. Judy Wasylycia-Leis: Let me ask a general question about pension governance. It's an issue that's very much on all our minds. We have a bill before the House, and I think it begs the question about what needs to happen through the Office of the Superintendent of Financial Institutions in terms of tightening up provisions around bankruptcy situations and the monitoring of pension plan contributions by employers. The requirements to ensure that worker pensions are protected for their retirement would, in my estimation—whether we look at the issue of Voyageur or Stelco or Air Canada—need to be tightened.

I would like to know what you would see as necessary in this regard, how you would improve provisions for employer pension holidays, for example, to prevent pensioners from losing their life's savings, and whether or not you would agree that raising the ratio that triggers a contribution holiday would be effective, for instance, since it's currently 110%?

● (1205)

Mr. Nicholas Le Pan: Let me respond to two or three of those kinds of things.

With respect to pension holidays, we do not have a 110% trigger. Starting several years ago, we commenced doing our own estimates of the updated solvency positions of the plans we regulate and supervise to identify ones where more investigation might be necessary to confirm whether they'd fallen into deficit from being in surplus. We did, through that process, identify a number of plans we thought had moved from surplus to deficit and yet were still taking contribution holidays, and where we thought it was totally inappropriate for that to occur. We've basically dealt with all those cases, and that will be reported on in our upcoming annual report. We dealt with all those cases satisfactorily.

I totally agree that if a plan slips below 100% coverage, it ought not to be taking contribution holidays. I think there are a number of other things—and some of them are referred to in the report on plans and priorities— concerning regulatory initiatives we're involved in; they're referred to in the section towards the end of the report on plans and priorities, in table 7 on page 46. A number of regulatory initiatives are outlined there that I believe are important, related to pension solvency.

For example, I believe we need to move forward with a regulation that will deal with voiding certain increases in benefits that have occurred just before a plan goes into a problem. I think we need to deal better with what happens on funding when a pension plan terminates. The Department of Finance indicated, when they came before this committee, that they intend to roll a number of those initiatives into a package of initiatives on pension plan funding shortly. I strongly support that.

When it comes to more general legislative changes to alter the priority of amounts of unfunded deficits, for example, in a pension, some of which you've referred to—there are various pieces of legislation in that territory—I think there are a couple of considerations that have to be looked at. Ultimately it's not OSFI's decision; it's a decision of the government and Parliament as to whether those priority rules should be altered. But I would note that altering the legislative priority in bankruptcy for unfunded pension liabilities may lead to significant impacts on the willingness of lenders and other creditors in the marketplace to advance funds to enterprises with defined-benefit pension plans.

We have already seen a move away from defined-benefit plans and towards defined-contribution plans. Some of that's noted in our annual report for the plans we regulate and supervise. I can't comment about the situation in some of the companies you mention, because they're provincially regulated plans, but depending how it was done, I think changes in the priority in bankruptcy could affect the willingness of lenders to advance money to enterprises and therefore could affect the willingness of those enterprises to want to maintain defined-benefit pension plans.

I'm not saying that's necessarily.... I just think it's a factor that needs to be taken in to account, quite frankly, and would need to be assessed in that kind of legislation, and in determining whether that legislation should proceed.

There are a number of things in the environment that are stacked against defined-benefit pension plans. I don't want to say that defined-benefit pension plans, versus defined-contribution, are always the best, but I'm worried that there are things that are stacked against people wanting to maintain these plans. I think some of those factors should be taken into account by committees, Parliament, and government in thinking about whether to change the rules of priority in bankruptcy for unfunded pension liabilities.

I'm not saying that therefore it shouldn't be done; I just think those are factors. Those are decisions for others to take, but I think some of the things we've indicated here that are being rolled into a package of pension measures, I gather, by the Department of Finance and the Minister of Finance are good initiatives.

The Chair: Thank you, Ms. Wasylycia-Leis.

Mr. Pallister, then Mr. Hubbard, Mr. Harris, and Ms. Minna.

● (1210)

Mr. Brian Pallister (Portage—Lisgar, CPC): I thank you for your presentation, Mr. Le Pan, and I ask the indulgence of my committee colleagues in asking some pretty basic questions just by way of review. I'm sure I could dig this information up out of your reports, but I'll just ask you some simple straightforward questions—softball questions.

The first one is this. You say in your report that OSFI is not government funded; it's funded by the financial services industry. Could you just tell me what percentage of your funding comes from the financial services industry and what percentage comes from government?

Mr. Nicholas Le Pan: Of approximately $83 million of our costs, the estimates and RPP show that $730,000 comes from the consolidated revenue fund. All the rest of the $83 million comes from financial institutions or pension plans. So what's $700,000 over $83 million? It's very low.

Mr. Brian Pallister: Okay. But then you said the actuarial office is largely funded by the—

Mr. Nicholas Le Pan: The $730,000 is all related to the actuary's office. So the part that deals with financial institutions and pensions plans—100% of that comes from the institutions and pension plans.

Mr. Brian Pallister: Okay.

You were set up in 1987?

Mr. Nicholas Le Pan: Yes, in 1987.

Mr. Brian Pallister: So how was this work done before, or was there any work like this done before? What institution did you follow on the heels of, or what caused your operation to be created in the first place?

Mr. Nicholas Le Pan: Prior to 1987 there were two organizations: one was called the Inspector General of Banks and one was called the Superintendent of Insurance. Those two organizations go back many years and were created for the same reasons as OSFI exists—fundamentally to protect policyholders, depositors, and so on. The Superintendent of Insurance goes back to the 1880s and the Inspector General of Banks was formed somewhat after that. But pursuant in part to recommendations of Parliament, which reviewed the issues with the failures of banks in western Canada, and the post mortems and so on, OSFI was created through the merger of those two predecessor organizations. We undertook a major effort to upgrade resources, and we continue to do that at various points.

Mr. Brian Pallister: The two major banks were...?

Mr. Nicholas Le Pan: Canadian Commercial Bank and the Northland Bank.

Mr. Brian Pallister: As I recall, around that time there was a problem with a company called Pioneer Life as well, a life insurance company.

Mr. Nicholas Le Pan: Yes. It's before my time, quite frankly, at OSFI. But there have been a number of life insurance problems over the years, but I think Pioneer was actually a provincial company.

Mr. Brian Pallister: Okay. And provincial governments have their own superintendents of insurance and so on.

Help me on this one. A mutual insurance company could be provincially chartered and it could be federally?

Mr. Nicholas Le Pan: Yes. Something like 95% of the life insurance companies are federally regulated, and you could be either a stock company or a mutual company. Several years ago the rules were changed to permit mutual companies to demutualize, and a number of the major mutual insurance companies demutualized.

● (1215)

Mr. Brian Pallister: Right.

The property and casualty side has been the subject of much derisive comment and criticism over the last several years. My concern would be that a lot of that might not be based on fact, but rather, solely on premiums. The observation that premiums may have risen in a number of companies as a result was a major election issue provincially in New Brunswick in the last election, and so on.

Your mandate is to try to give Canadians a sense of security in the financial institutions. Do you do any communications work to help the public understand the vagaries of the property and casualty business, to put their minds at rest to any degree when prices go up and down, or is that something totally outside your mandate?

Mr. Nicholas Le Pan: Our focus, as I said earlier, is safety and soundness. We did do a public report on the property and casualty industry about a year and a bit ago, and in part that was an element of a communications approach to explain a little bit our perspective on what was going on. We have no role, as I said earlier, in regulation of rates or in regulation or product features, and those kinds of things.

Mr. Brian Pallister: It's the market's responsibility.

Mr. Nicholas Le Pan: Those are provincial responsibilities. What we've emphasized continually when we've been asked...and we did a year ago and two years ago. I could understand why, if rates were an issue—auto rates or whatever—provincial governments wanted to act. As you said, that was a major issue in different provinces, and still is in some provinces. We emphasize the importance of taking actions, if it were to occur, not only on the revenue side, on the rates, but also on the cost side.

A year and a half ago, we had an industry in which basically revenues weren't covering cost; they were eating into capital. So if we were going to avoid a safety and soundness issue, we thought there had to be action on both sides. And that's generally what happens. There have been major changes in what's happened with respect to products and redress mechanisms and soft tissue injury and all that kind of stuff.

Those decisions are up to provinces to decide, and my job is to deal with the implications, whatever those implications may be, to undertake actions that we need to take to protect people, which might include having to actually shut something down early to save money.

Mr. Brian Pallister: I have one minute, so I'll just quickly segue into this interrelationship, or overlap-duplication issue, with regard to CDIC.

The work of the Canada Deposit Insurance Corporation, it seems to me, would be somewhat related to your mandate. Could you give us an idea of what savings you might anticipate if we were to proceed with some kind of a cooperative merger of those activities? Historically, your office was created by just such a merger.

Mr. Nicholas Le Pan: The recent announcement and actions by CDIC, the government, and OSFI have two impacts. The first impact, and the biggest one, I think, is actually to reduce compliance costs for financial institutions. That's related to CDIC's getting out of the business of having standards, because those were duplicative of our rules and guidance, and so on. CDIC is getting out of that, and it reduces compliance costs to institutions that had to put up with two sets of rules.

We have also approached the life insurance industry, because when CDIC put its standards in place, we worked for the life insurance industry to put similar standards in place for that industry. Those are also duplicative of our other rules and guidance, so we think those ought to be eliminated as well, which would also reduce industry compliance costs.

The second impact is the review of the back-office services I talked about earlier. I think it will primarily focus on things like IT and that sort of kind of thing. At this point, I do not have an estimate of what its impact is going be. As I testified earlier, we've started up a process—Donna Pasteris here will be a key part of it—of working with CDIC to produce a plan. I think we will save some money—no question—but I won't know how big that will be until about June.

Mr. Brian Pallister: I appreciate your answers, and I thank you. I know any efforts you can make in terms of reducing compliance cost and time for these companies will be well appreciated.

Mr. Nicholas Le Pan: I do, too.

The Chair: In consideration of the $86 million in the estimates, how much of that comes from government or government agencies?

Mr. Nicholas Le Pan: How much comes from government or government agencies? Well, if we look, for example...let me see what the best table is to look at.

The Chair: You can get back to me.

Mr. Nicholas Le Pan: I'm just working through what the best breakdown is, what the best table is to go through that. It's probably pages 43 and 44 of our report on plans and priorities.

If you look at the bolded numbers at the bottom of pages 43 and 44, table 4, for 2005-06 you see $83,164,000. That's basically equivalent to our costs, the $83 million in costs.

Now, of that—let's back up. First of all, the office of the chief actuary has cost-recovered services—slightly above that—of $4.1 million. That is coming from other government departments, basically—HRDC, whatever. Of international assistance, further up that column, $1.075 million is coming from CIDA. Okay? There is $1.075 million in cost-recovered services there, and that's it.

● (1220)

The Chair: But that wasn't there last year, right?

Mr. Nicholas Le Pan: Last year it was $1.2 million. The year before, if you look over to the left-hand—

The Chair: Because I compared it to the 2004 annual report, page 61, and it doesn't seem to....

Mr. Nicholas Le Pan: Page 61? Oh, in the RPP we're giving more breakdown. On page 61 of the annual report, if you go up in the revenue line, there's a cost-recovered services thing. There the total of $4,208,000—the $1.2 million, roughly, which was CIDA's that year—is included in that. Increasingly, as we move towards the new program activity architecture Treasury Board has put in place, we'll actually have more exposure, so our main estimates and our RPP are actually showing more breakdown in that table 4 than we are in our annual report.

The $1,175,000 is from CIDA; the $4 million in the chief actuary is from other government departments; and $755,000, which I've referred to before, is from the main estimates of the CRF. So that's $1 million, plus $4 million, plus $700,000...$6 million; that's it. The rest of the $83 million comes from institutions. Okay?

The Chair: At arm's length? Okay.

Mr. Hubbard, Mr. Harris, and then Ms. Minna.

Mr. Charles Hubbard (Miramichi, Lib.): Thank you, Mr. Chair.

I think a lot of my questions have already been asked by others. Regarding the expression “federally regulated pension plans”, what determines if a pension plan is federally as opposed to provincially regulated?

Mr. Nicholas Le Pan: It's a good question.

Essentially, federally regulated plans are plans for the so-called federal employers under the Canada Labour Code. Those are things like the banks, and interprovincial transport—which is what gets us into Air Canada, into shipping, and that kind of stuff— plans in the territories, so we deal with a number of plans for territorial employers; plans in aboriginal communities, and that's—

Mr. Charles Hubbard: It doesn't necessarily mean a company that operates in more than one province.

Mr. Nicholas Le Pan: No. You could be a federal employer and not be operating in more than one province.

Mr. Charles Hubbard: In terms of the federal inspection, the federal regulations, and the federal supervision of its plan, Air Canada has come up short, and there is a tremendous amount of money that has to be paid back into it. With that idea of a plan being so short, what was the problem? Was it lack of paying into the plan, or a company withdrawing from the plan without proper approval, or with somebody's approval? What exactly happened with that plan that caused the big shortage?

Mr. Nicholas Le Pan: The first point I want to make is that the legislation and regulations deliberately allow defined-benefit plans to operate at a deficit. That's deliberate, because if they weren't allowed to operate at a deficit, in my judgment you would see far fewer defined-benefit pension plans in this country. There are a number of plans at any one period of time that are operating at a deficit.

In the case of the Air Canada plan, it was not a circumstance of money having been pulled out, in my judgment. The plan had previously been in significant surplus. It moved, over the course of about a year and a half, from significant surplus to deficit. The sponsoring company was taking a contribution holiday, as allowed in the regulations, based on the previous surplus.

Meanwhile, several things were going on. Asset markets were weakening, which was affecting the asset side of the plan's balance sheet. Long-term interest rates were dropping, which was moving up the value of the liabilities. And the ability of the sponsor.... Money wasn't going in because they were taking a contribution holiday, as per the regulations, and the sponsoring organization's ability to fund the deficit was being undercut by conditions in the airline industry.

We have had lots of examples of plans with 10% or 12% or 13% deficits that the plans have been able to pay off over the five years normally allowed. A 10% or 13% deficit is not prohibited by their legislation and regulations. What's hugely important is the ability of the sponsoring organization to fund that deficit over the period of time normally required, which wasn't here in this case.

● (1225)

Mr. Charles Hubbard: With the pension plans, and as you supervise them, there appear to be two different applications, one in terms of those who have retired and another of those who are still part of the workforce. Is there a distinction in these federally regulated plans, such that the ones who have retired are protected, in terms of having enough?

I'm referring actually to New Brunswick, where we have a difference with a company called Nackawic, which shut down, leaving the pension plan short. Those who had retired seemed to have their benefits guaranteed, but those who didn't retire have virtually very little.

But these federally regulated plans make no distinction between those who have retired and those who are still part of the workforce?

Mr. Nicholas Le Pan: I'm not aware of the situation you're talking about. I suspect it's a provincial plan.

The general scheme federally is that the legislation places considerable reliance on the terms and conditions of the plan. The federal legislation does not specify, if there were a problem, how that problem is shared between the various parties in the plan. That is dependent entirely on the arrangements of the plan, because these are ultimately voluntary arrangements between employees and employers. We have seen plans in which the priority, if there is a problem, is equally distributed across current members as well as retirees. We have a number of plans where the priority goes to retirees, and where that's been negotiated as a matter of collective agreement, for example.

So there are a variety of arrangements, and that is not regulated by the legislation. But we treat our responsibilities as equivalent.

The Chair: I want to try to keep it to five minutes, because I want to fit in both Mr. Côté and Ms. Wasylycia-Leis for a couple of minutes afterwards.

I now have Mr. Harris, and then Ms. Minna.

Mr. Richard Harris (Cariboo—Prince George, CPC): Thank you, Mr. Chairman.

I have one very small question that I've been waiting for an opportunity to ask somebody who was related to this question. In the last three parliamentary terms there has been a Secretary of State (International Financial Institutions). OSFI played an intimate role with that particular minister. Now that's changed; there no longer is that minister. And if it's appropriate, I just need an observation. How has that impacted the operation of OSFI? Has it been a beneficial move? Has it been a streamlining move? Or would you have perhaps preferred to continue working more closely with a direct minister?

Mr. Nicholas Le Pan: I don't have any comment. In my career, I've worked with a variety of ministerial arrangements.

The only other point I'd make is that if we need to deal with a minister because we have a problem that a minister either needs to know about or needs to be part of a decision about, whether it's one or two, we'll get it done.

The Chair: Ms. Minna.

Hon. Maria Minna (Beaches—East York, Lib.): Thank you very much.

I want to go back to a couple of things. One is the pension fund that my colleague was just asking about. Basically who rings the bell on the pension funds when there's a problem? That's one area that I'd like to know about.

Mr. Nicholas Le Pan: If I take Air Canada as an example, since it's been talked about a fair amount in the public domain, some number of months before it came to a head, essentially we started to have increasing concerns that the plan had probably fallen into deficit and that it was perhaps therefore not appropriate to continue contribution holidays. So we started to raise the issue. We were not satisfied with the initial response. We went up the organization, escalated, and we eventually issued formal orders to the plan and the plan administrator. So in a number of cases of our interventions, it occurs because we identify a potential problem or an actual problem.

In some other cases, it occurs because people bring us the problem. They say, "We have a problem". We are not in the business of replicating fully the governance and the role of appointed actuaries and all that kind of stuff. They have formal responsibilities, and sometimes it comes from them, but it quite often comes from us.

But often it will come because we have identified the potential for a problem, and then we verify that it's actually a problem.

● (1230)

Hon. Maria Minna: Just to piggyback, to continue in this area, you mentioned earlier that the economic indicators suggest that it is a stable but fragile outlook on the pension funds at the moment. If one looks at the interest rates, higher interest rates are actually more beneficial to pension funds than lower interest rates.

Mr. Nicholas Le Pan: Sorry? Higher interest rates...?

Hon. Maria Minna: Higher interest rates are actually more beneficial to pension funds than lower interest rates is one point of view. Given that the pension funds are in a fragile state, is that likely to influence the interest rate setting, and do you communicate with the Governor of the Bank of Canada with respect to that area? Is there a discussion that goes back and forth?

Mr. Nicholas Le Pan: No and no.

The Bank of Canada is in the business of setting short-term interest rates. What matters for pension plans are long-term interest rates, which are much more largely market determined, and so it's an environmental factor. I don't have any discussions with the governor about setting of short-term interest rates.

Hon. Maria Minna: Do you know at this point what percentage of the pension funds would be in...?Given, as you said, that it's a fragile situation, do you have a sense of a percentage of how many funds would be among the most vulnerable?

Mr. Nicholas Le Pan: I think somewhere in the material I could probably identify exactly, if I had a few minutes, but I know somewhere in either the annual report or the RPP we've provided an indication that, for example, if long-term interest rates were to be a couple of hundred basis points higher than they are today, that would deal with 85% of the funding deficiencies we now have. But I'm not calling for higher interest rates. As I said in my opening remarks, this is an environmental factor that we need to take into account. If long-term interest rates were to decline further, as they have, that would add to funding difficulties.

So this is not me taking a position on what interest rates should be. It's me looking at how we meet our mandate given the environment that's out there.

Hon. Maria Minna: You mentioned earlier, if I'm not mistaken, that you would not be discussing the actuarial work with us. I was going to ask about the CPP long-term. Is that something we need to do maybe with someone else at another time?

Mr. Nicholas Le Pan: Yes, the chiefactuary's report is public. The peer review report will come out shortly. But I think to the extent that the committee wants to get into some of the policy issues, some of the assumptions, it would be much more appropriate to do that with the stewards of the plan, including the finance department; the CPP Investment Board, which is responsible for and has big input into the investment assumptions; and with the chief actuary. And I'm not trying to duck, because I think those are legitimate questions, but in terms of the accountability I think it's better.

Hon. Maria Minna: That's fair enough. I just wanted to hear that.

I just want to go to something else now. Regarding the issue of money laundering and so on, and anti-terrorism, which we have, I just wondered what role OSFI plays in assisting other agencies in detecting and deterring terrorist crimes and events? Is there a role you play in that?

Mr. Nicholas Le Pan: There's a general role, because as I've mentioned earlier, for regulated financial institutions, based on our risk framework and our capabilities, we are trying to assess the quality of financial institutions' anti-money-laundering compliance programs and where we see deficiencies. That's top-down. And that's a complement to what, for example, FINTRAC does, bottom-up, looking at transactions, looking for patterns, and so on. We actually share info with FINTRAC, and we help FINTRAC develop its own compliance methodology.

So there's that sort of general complement, that kind of free relationship. Secondly, with respect to FINTRAC, for example, there's a specific exchange of information on what we're seeing and what they're seeing, and I think that's totally appropriate.

The Chair: Thank you.

I'd like to get done by

[*Translation*]

quarter to.

Mr. Loubier, please.

Mr. Yvan Loubier (Saint-Hyacinthe—Bagot, BQ): Thank you, Mr. Chairman.

You talked earlier about supervision of financial institutions in the area of criminality, including money laundering. I understand from what you said that you exert this supervision from the top down, while the other organization does so from the bottom up.

Have you ever made an investigation on Canadian banks' branches located in countries that are considered tax havens? In the Caribbean, for example, there are 50 branches of the four major Canadian banks. We know that in that area of the world, sound capital and laundered money often end up in the same institutions. Whose responsibility is it to keep an eye on the transactions made by these branches located in tax havens?

● (1235)

Mr. Nicholas Le Pan: As I just said, we deal with the quality of risk management systems, such as *Know your customer* and others, within the general organization of any large bank. We proceed by doing checks here and there. We could not guarantee that there is no problem, because these organizations are rather complex.

In doing our testing, however, we seriously take into account places or operations that involve higher risks. We take into account either the jurisdiction or the nature of transactions, for example wire transfers. We try to focus on these.

This requires once in a while that we travel in some foreign country in order to check the quality of processes for a given date. In Toronto, we were given explanations on the processes and, for our part, we have done some testing here and there. However, we would like to see whether it is the same thing elsewhere. Once in a while, we do little trips abroad to check what is going on locally. It is not like a full audit. Still, it is not good enough to always stay here to check on the quality of processes.

Mr. Yvan Loubier: Until now, Mr. Le Pan, have you found anything improper? If so, to whom have you forwarded the relevant information?

Mr. Nicholas Le Pan: Generally speaking, I am comfortable with the situation. However, as I have said several times, it is difficult, there are challenges and we should never be complacent. It is always important to improve on the situation and to take stock of the situation. Among other things, the situation is more difficult and complex when you deal with one of these larger organizations, when you're faced with millions of transactions. It has happened occasionally that we have found very significant deficiencies. Still, it is a fight that must be fought continually. It is never possible to say that everything is settled and that we can focus on something else.

You might say that our role is to continually exert pressure, to try and find ways of improving on the situation and to insist on results being achieved. Such is the nature of this battle.

The Chair: Is the situation the same for international banks that are active in Canada?

Mr. Nicholas Le Pan: Foreign banks' activities in Canada do not really concern us, but it is included in our supervision process. Our counterpart in the United States is keeping a watch on these banks. In the case of Citicorp, for example, the United States are dealing with the situation of these banks around the world. We cooperate somewhat with these branches in Canada in order to make sure that all is fine and we do forward the results of our investigations to our counterparts in the United States.

The Chair: Thank you, Mr. Le Pan.

[*English*]

Ms. Wasylycia-Leis, and then I have Mr. McKay.

Ms. Judy Wasylycia-Leis: I have four very quick questions. I'll do this all at once before I get cut off.

The first is with respect to the triennial review of CPP. I think it started in 2003, if I'm not mistaken. Where are we now, and how do we know when the review is done? If recommendations are made for change, do we find out as parliamentarians, or how is Parliament kept in the loop?

Secondly, there was the fiasco with the fax from CIBC that raised the issue of Canadians' privacy being exposed under the George Bush Patriot Act. Where are you with that?

Third, let's get back to the question of bank mergers. Should guidelines be forthcoming and proposals come to you, do you have criteria in place for assessing different things such as whether community access can still be maintained, whether the purchaser of any new branches must be Canadian, must have some history of experience, etc.?

Finally, what's your role in terms of the review of the Bank Act, which is expected to begin shortly?

● (1240)

Mr. Nicholas Le Pan: On the first point, to be very quick, the recent triennial review of the CPP is published; it has been published and tabled in Parliament.

There is a peer review of that review that I've organized because I think it's hugely important. We're pushing peer review for the actuarial profession. It's hugely important, and it's being done. It is in the process of being finalized and will be published and made available to parliamentarians when it's finished. If there are recommendations in there, historically the chief actuary has responded to those recommendations. But that's also to assure Canadians and parliamentarians about the quality of the work the chief actuary has done. I think within the next month or so it will be available. I don't have an exact date.

It's not being overseen by my office—that's a hugely important fact—it's being overseen by the government actuary department in the U.K., because I wanted it overseen by a totally independent party.

Concerning the fax and CIBC, what we do when these things occur, because mistakes are going to happen in these organizations.... We are not in the job of enforcing the Privacy Act; that's the Privacy Commissioner. The Privacy Commissioner is doing a review. I do not know when that review will be public. You'd have to ask the Privacy Commissioner.

When these things occur, we look at them also, at the same time, to see what they tell us about the quality of the control management process in these organizations, and to the extent we think there are deficiencies, we let them know. That's been done.

Concerning bank mergers, and what community access and what criteria there would be, and so on, we approach bank mergers, as I've said earlier, from our core mandate, which is safety and soundness. The issues of impact on community access and impact on service in small communities are all part of the public interest test that would be considered by the minister.

There are three parts to this. One is, as I said earlier, the safety and soundness stuff—that's my business to make a recommendation about—one is competition, and one is more public interest stuff, which involves the minister, parliamentary committees, and so on.

If as a result of a merger an institution I regulate and supervise was acquiring branches that were a significant part of their business—say they were growing by more than 10% of their business—that is something we would look at: are they capable of managing that; do they have a plan to do the operation? Again, it would be from a safety and soundness perspective, to make sure depositors are well protected, because that's the business I'm in. But those other things are part of the public interest test.

As for review of the Bank Act, we contribute to it. We use our experience of how the statute's working to suggest areas where we think it could work better. For example, in the material that was published with the budget, the minister indicated a couple of areas he'd like to review.

A couple of those are dear to my heart. The number of approvals in the statute, we think, could be reduced. I'm not talking about big bank mergers, but there are lots of approvals. We did something like 700 approvals that we report on here. The last time the statute was reviewed, the number of approvals was actually reduced, and they were shifted, some of them being more simplified and so on.

I think there's room to do that more, going back to compliance costs. The foreign bank provisions of the statute are amongst the most torturous and complex out there—very complex kinds of programs.

So we produce those rather more technical kinds of things, and we would be asked for reviews on other kinds of things, which we will give to the policy-makers.

The Chair: Thank you, Mr. Le Pan.

Mr. McKay.

Hon. John McKay (Scarborough—Guildwood, Lib.): Thank you, Mr. Chair, and thank you, Mr. Le Pan.

The beauty of going last is that pretty well everyone else has asked all the questions you were interested in. Here are two questions, one a relatively small question, the other a more philosophical question.

In your total planned spending, you're a relatively small operation in terms of net. You have a line here, "non-respendable revenue" and then later the document talks about sources of non-respendable revenue and non-respendable filing penalties. I don't understand that. Could you explain it to me?

● (1245)

Mr. Nicholas Le Pan: Several years ago we put in place penalties for institutions that were materially late or erroneous in filing the returns they were required to file with my office, because we believed that getting some more discipline in this would be crucial to the quality of information we get and would actually reduce our direct costs of having to check this stuff, go back to people, and so on.

The regulations that put those filing penalties in place made clear that the money we collect goes to the consolidated revenue fund, not to us to respend, and that's the money here.

The amount involved has decreased significantly, as we expected it would, because people have gotten much more on time and have much better focus on actually doing the numbers right. In the first year, I think it was about double this—$700,000, roughly speaking. Now it's down to about $300,000.

That's what it is.

Hon. John McKay: This is my second question. You've been responding to several members indicating your nagging concern about this low interest rate environment. When in your opinion does this get to be quite significant to the pension system generally?

Mr. Nicholas Le Pan: Again, this is a judgment call. If the current environment continues for both interest rates and asset markets—so no weaknesses in asset markets or further reductions in interest rates—it will be a manageable situation for the plans that we regulate and supervise and it will take a number of years for some of those plans to work their way out of deficits. We've already seen some improvement in the past couple of years—in the past year or so—and it would continue, but it would not be an overnight thing because of the need for sponsors to put up money over a period of time.

I think that's a perfectly reasonable scenario. That scenario does not cause me concern. If we have asset markets drop by another 15% to 20%, for example, on that side, or we have another further material reduction in long-term interest rates, we're going to add a lot to solvency deficits. We'll deal with that. It will increase the push for more spreading out of funding. It will increase the need to restructure benefits in some plans. Some of that is happening and it's happening on a consensual basis, and I think that's good.

I can't give you a better answer than that. We're in the business of responding to the environment that's out there. I'm not in the business of recommending what ought to happen to interest rates and I'm not in the business of forecasting peripherally what's going to happen on the stock market.

The Chair: Thank you, Mr. McKay.

Thank you, Mr. Le Pan. Thank you for your time, Ms. Pasteris. It was very informative.

We can go directly to the estimates. We don't have to clear the room. We can go directly to it.

From what I understand from the committee, we looked at the main estimates on votes 1, 5, 10, and 15, and today we looked at vote 35.

Could we do this in bulk, *en vrac*? Yes.

Mr. Charlie Penson: Mr. Chairman, the committee will recall that there were no votes taken on the estimates because of a technical glitch on Thursday, so the intent was that we would deal with those at today's meeting.

I just want to make clear that's what's happening today.

The Chair: Yes, we're doing last week's and this week's.

Shall votes 1, 5, 10, L15, 30, and 35, less the amount voted in interim supply, carry?

FINANCE

Department

Vote 1—Operating expenditures..........$84,048,000

Vote 5—Grants and contributions..........$944,000,000

Vote 10—Transfer Payments to the Territorial Governments..........$1,800,000,000

Vote L15—Issuance and payment of demand notes to the International Development Association..........

Financial Transactions and Reports Analysis Centre of Canada

Vote 30—Program expenditures..........$27,663,000

Office of the Superintendent of Financial Institutions

Vote 35—Program expenditures.........$755,000

(Votes 1, 5, 10, L15, 30, and 35 agreed to on division)

The Chair: Shall the chair report the estimates to the House?

Some hon. members: Agreed.

The Chair: Thank you.

This meeting is adjourned.

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