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## Standing Committee on Finance

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**Tuesday, March 27, 2007**

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**Chair**

**Mr. Brian Pallister**

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•(1105)

[English]

**The Chair (Mr. Brian Pallister (Portage—Lisgar, CPC)):** Good morning, ladies and gentlemen, and welcome to our officials from the Canada Revenue Agency. It has been so long since we've seen you last. I'm sure you're engaging in some pre-season training to get ready for the end of April. We're glad you were able to make time for us today.

I call vote 1 under Canada Revenue Agency.

Mr. Baker, will you make some introductory comments?

**Mr. William Baker (Deputy Commissioner and Chief Operating Officer, Canada Revenue Agency):** Thank you, Mr. Chair.

[Translation]

Firstly, Mr. Chair, thank you for inviting me to appear before the committee today, to discuss the CRA's main estimates.

Before I begin with some brief introductory remarks, I would first like to introduce two of my colleagues who have accompanied me today. James Ralston, Chief Financial Officer and Assistant Commissioner of the CRA's Finance and Administration Branch, and Mary Jane Jackson, Deputy Assistant Commissioner of the Finance and Administration Branch.

[English]

The CRA's 2007-08 main estimates are seeking an increase of some \$152 million to its authorities over the previous year. This represents an approximately 4.7% year-over-year increase on the mains.

This increase is related primarily to an adjustment of \$99 million related to collective agreements. This is, of course, about two-thirds of the increase that's being sought.

There is a transfer of \$49 million for the national collection services from Human Resources and Social Development Canada. This is in regard to the student loan program. This includes \$21 million in payments to private collection agencies who are involved in that part of our business.

There is an increase of \$48 million in re-spendable revenue, reflecting primarily an increased demand for information technology services by the Canada Border Services Agency.

Mr. Chair, if I may offer a note of explanation, in 2003 when the Canada Border Services Agency was spun off as a stand-alone agency in the public safety portfolio, it had until that time been part of the Canada Customs and Revenue Agency. We continue to

provide IT support to the border agency because many of our systems and much of our infrastructure is integrated. So this is a reflection of their increased activity.

There is an increase of \$19 million to address legislative policy and operational initiatives arising from past federal budgets, including the universal child care benefit and other minor adjustments, such as the new textbook tax credit, the tax credit for public transit passes, and the children's fitness tax credit.

You may recall that when we were last here, which was March 1, on supplementary estimates (B), there was a question about what you need. That was for the current fiscal year, 2006-07. This reflects the ongoing costs, and if you notice, it's lower than what we would have needed to get started up, which was the subject of a question that came from one of the members in early March.

There is also an increase of \$18 million for the children's special allowance. This is a statutory payment for eligible children in the care of specialized institutions, reflecting an increase of \$21 a month per child for the 65,000 children who receive this benefit.

If you did the math on that, that actually comes up to \$233 million, but it's offset by a number of factors. There is a \$69 million reduction related to the Canada Revenue Agency's contribution to government budget reduction exercises. There is also a recovery of \$12 million from the Canada Pension Plan and EI account to cover the increased costs of administering the agency's CPP- and EI-related responsibilities, yielding a net yearly increase of \$152 million over last year's mains.

[Translation]

Mr. Chair, that concludes my opening remarks. My colleagues and I would be pleased to answer any questions that committee members may have.

Thank you.

**The Chair:** Thank you very much.

We will begin with Mr. McCallum. You have six minutes.

[English]

**Hon. John McCallum (Markham—Unionville, Lib.):** Mr. Chair, this presentation was so rapid, I'm not sure I've collected my thoughts.

**The Chair:** But you have to agree the quality was there.

**Hon. John McCallum:** The quality was excellent.

I have been looking through these estimates, and I'm trying to figure out—but I can't tell from the numbers here, and perhaps you can help me—the amount in additional costs incurred as a consequence of small tax credits of various kinds, as opposed to simple taxes.

We have—and you know better than I do—a plethora of new targeted tax credits. Is there any way you could tell us—if these numbers are not here—or you could explain what that has done in terms of the costs of administration?

**Mr. William Baker:** Mr. Chair, with your permission, I'll ask Mr. Ralston, the chief financial officer, to give you more detail in terms of the specifics.

**Mr. James Ralston (Chief Financial Officer and Assistant Commissioner, Finance and Administration Branch, Canada Revenue Agency):** The first comment is that the amount Mr. Baker referred to as relating to the 2006 budget is primarily related to the UCCB, the universal child care benefit. As you probably know, there will be further requirements. Mr. Baker mentioned that when we were here for the supplementary estimates (B) of 2006-07, we got some funding for the 2006 budget related to that fiscal year only. We will be coming back in subsequent supplementary estimates for 2007-08, and there will be the continuation of some of what was, in effect, one-year funding at that time.

The full cost of implementing some of the measures that you referred to are not reflected in the main estimates at this point in time. They will be reflected when we come back for supplementary estimates.

• (1110)

**Hon. John McCallum:** When we will receive those numbers?

**Mr. James Ralston:** That will depend on when the supplementary estimates are first brought forward. At that time, we expect to have amounts related to the continuation of that funding, and we'd be in a position to give you the details at that time.

**Mr. William Baker:** If I might add something, Mr. Chair, in the normal pattern, supplementary estimates (A) would occur sometime in early or mid-fall. At that point, we will have costed any items that were mentioned in the budget that was just tabled, in terms of what the administrative impacts might be.

**Hon. John McCallum:** I have another question on a different subject. I remember that when I was Minister of Revenue, we had a number of advisory committees. There was one committee in particular advising on disabilities. I'd ask you to correct me if I'm wrong, but my understanding is that this advisory committee was simply terminated.

A member of the committee came to see me a few months ago, saying that its members were very upset to have been preemptorily disbanded, and that indeed the committee was continuing its work on

its own, at its own expense. He had written a letter to the minister and had not, after several months, received any reply. I'm wondering if that's true.

More generally, is it true that many of these advisory committees have simply been disbanded, so that agencies are no longer hearing from stakeholders in the way that used to be the case?

**Mr. William Baker:** Mr. Chair, it is true that the standing advisory committees—and they would have been in place during your time as minister, Mr. McCallum—were dissolved in their current form. As a result, this was one of the items in the expenditure reduction exercise that was announced last September. In lieu of those, we're looking at each individual sector and are working out the right way to obtain input from the particular interest group, whether it's small business or disabled.

If I might use an example just to illustrate, there was also a small business advisory committee. In lieu of having a standing committee, we've regrouped some representatives of small business to look specifically at issues as they affect small business. We started this process late last summer, and we call this an action task force, which has been mentioned a couple of times in the context of paper burden reduction. It looks at what can be done to simplify the lives of small business people.

Our view is that we are more effective working with particular groups if we can target our engagement with them on specific problems, with a view to identifying specific solutions. So we still engage with any interested group.

**Hon. John McCallum:** This is my last question.

On the issue of the disabled, approximately when was this group disbanded, and has another group of any kind been reconstituted? Is there any advisory activity related to people with disabilities going on at this time?

**Mr. William Baker:** The announcement on that exercise came out, I believe, in September 2006, so the committee would have been dissolved around that time. I honestly cannot tell you today, sir, what specific activities have been involved with the disabled groups or their representatives, but I would be pleased to report back to the committee on that, with the permission of the chair.

**The Chair:** You have the permission of the chair, certainly, sir. I'd encourage you to get that information back to the committee. I'd appreciate that.

[Translation]

We will now continue with Mr. Paquette. You have six minutes.

• (1115)

**Mr. Pierre Paquette (Joliette, BQ):** Thank you, Mr. Chair.

Thank you for your presentations.

In December, a few months ago, we noticed that there was a problem concerning the Attikamek community. It was noticed that the sampling was somewhat skewed because of the audit criteria used by the Canada Revenue Agency. What has happened since?

I know that people have received their cheques, that they have been reimbursed, but have you reviewed your sampling methods? Did you decide to conduct new audits with certain members of that community? What has happened exactly?

**Mr. William Baker:** Mr. Chair, under the provisions of the Income Tax Act, it is not possible to talk about specific cases. However, I would be willing to provide this committee with an update on that issue at a later time.

**Mr. Pierre Paquette:** The problem that was cited was that because of the criteria used in the random sampling, certain segments of the population were targeted more than others.

It is important that the committee be made aware of the efforts the agency has made to ensure that the criteria are as objective as possible. I would greatly appreciate a follow-up on that issue.

**Mr. William Baker:** Mr. Chair, I can assure you that our case selection process of cases is absolutely fair. I am more than willing to provide you with information to that effect.

**Mr. Pierre Paquette:** Can the audits you conduct on the various parts of programs you administer be found under the heading "Reporting Compliance"?

**Mr. William Baker:** Yes. Most of the time, it depends on the documents that taxpayers do not provide. Sometimes it is necessary to do a follow-up, or pay a visit to a taxpayer's business or residence to obtain more information, carry out interviews, or do what is necessary to corroborate facts.

**Mr. Pierre Paquette:** I want to return to the issue of private collection agencies.

Under the heading "Payments to Private Collection Agencies Pursuant to Sections 17.1 of the Financial Administration Act" there is the amount of \$21 million.

Can you please explain to us once again why the CRA decided to use the services of private collection agencies? Is it profitable to do so?

**Mr. William Baker:** We do so with a very specific goal in mind. With your permission, Mr. Chair, I will ask my colleague, Mr. Ralston, to answer that question.

Thank you.

[English]

**Mr. James Ralston:** As Mr. Baker, I believe, mentioned, the private collection agencies work only in relation to the student loans, not in relation to taxpayer accounts. And even at that, not all student loan recipients would be contacted by private collection agents. Only a portion of that workload is handled by them.

The amount that you referred to, \$21 million, is our expectation of likely spending on commissions to the private collection agents in the upcoming fiscal year. I do have some data on past activities. For example, in 2005-06 approximately \$13.5 million was spent to collect approximately \$74.5 million. In 2006-07—and these would be partial-year figures—\$11.4 million was spent in respect of collections of \$68.6 million.

• (1120)

[Translation]

**Mr. Pierre Paquette:** How do you explain, then, the figure of \$21 million? You were citing figures that date back to 2005-2006, which range between \$11 million and \$13 million. That amount is now \$21 million.

I would also like you to explain once again why you turn to private collection agencies to collect, for example, student loans?

[English]

**Mr. James Ralston:** We do an analysis of accounts and determine which ones are appropriate for our own collection force to pursue and which accounts are appropriate to turn over to the private agencies.

Concerning the level of activity, as I said, the \$21 million is really a forecast. It may indeed turn out that the level of activity would be somewhat less, as certainly the historical experience has been.

[Translation]

**The Chair:** Thank you.

[English]

The next questioner will be Mr. Wallace.

Sir, you have six minutes.

**Mr. Mike Wallace (Burlington, CPC):** Thank you, Mr. Chairman.

Thank you for being here today.

I have a few questions. On managing the appeals side, it looks like we're having a bit of a bump in costs. I don't know what the actual volume is in terms of a percentage. Oh, there it is, 14%.

Can you explain whether we are seeing more appeals by taxpayers, or are they just taking longer? Why has that gone up 14%?

**Mr. William Baker:** Mr. Chair, I don't have the volume of appeals here. I don't think we're looking at a significant number.

One thing we are finding generally is that the files that are going to the appeals, which is the administrative stage of redress in the agency, are increasingly complicated. The more work we do—and we are going to do even more work in light of the recent budget in the areas of tax shelters, international tax non-compliance and what have you—the more appeals we generate, and they are often more complex appeals to dispose of.

**Mr. Mike Wallace:** Okay, I appreciate that.

Maybe you could explain something, because I basically don't understand it. The contributions in support of the charities regulatory fund is doubling, if I read this correctly, from \$1 million to \$2 million or whatever that number is...we're basing it in dollars, I think. Can you explain what that is?

**Mr. William Baker:** I'll ask my colleague Mr. Ralston to give you more precision than I'm capable of.

Thank you, Mr. Chair.

**Mr. James Ralston:** I can't recall exactly, perhaps in 2005-06, but there was a substantial investment in the charities regulatory reform area. One element at that time was a \$1 million fund, which was a way to partner with certain charitable organizations, or associations of charities, to provide information about how these charities should comply with the Income Tax Act.

You're seeing that initial \$1 million level of funding, which I believe is now being increased to \$2 million to perhaps reflect more room for engagement in that kind of activity.

**Mr. Mike Wallace:** So it's based on demand from charities and the requirement to get them into compliance. We need to spend some more money in that area. Is that what you're telling me?

**Mr. James Ralston:** Yes. The idea is that we'll get better compliance if the charities understand their obligations better. This is a program that's meant to advance that aim.

**Mr. Mike Wallace:** Right.

On a different topic—and maybe you cannot help me and you could steer me in the right direction—I had a gentleman come to see me with his tax form. I don't have it with me. At his count, it had 25 different percentages in it. Some of them were 15.5%; you multiply it by 15.5%. They weren't even round numbers, they were all decimal points.

He is a senior citizen. He was thinking that the form had become very complicated. He was not happy with the variety of percentages, that it's not even in round numbers and so on.

On reporting compliance, we're up a little, but not a lot. Are we having any difficulties in reporting compliance due to the difficulty of the form?

• (1125)

**Mr. William Baker:** Mr. Chair, as for the increase you're seeing in reporting compliance, essentially this is a way of characterizing our audit work, primarily—when people have complied, they have filed, but we have to check their records; they have to check the accounts. This is more representative of an increased level of effort that the agency has been making over the years, supplemented at times by additional budgetary money to increase our audit presence in areas of higher risk.

Again, the examples I'll use are well-understood tax shelters, international tax avoidance, underground economy—those are the areas. And we have been increasing our level of effort in that area over time.

**Mr. Mike Wallace:** Recently you've been in the news about some computer issues. I'll give you a chance to fill us in on where we are with that and how we're doing in terms of accepting electronic filings. The other thing I'd be interested in knowing, if you have the figures, is what percentage of the public submit electronically rather than using paper submissions.

**Mr. William Baker:** Mr. Chair, with permission, I'll answer your second question first; that's easier. We estimate that about 52% file electronically, and that would be from the home through NetFile or through a tax preparer, through electronic filing, and other filing options that have been around for awhile, including Telefile.

I can tell you, Mr. Chair and members of the committee, that we fully restored our operations since experiencing the difficulty we had about three weeks ago, and all manner of filing tax returns is back to normal, whether it's by paper, electronically, through tax preparers, or otherwise.

Cheques started going out last week for people who may have been impacted initially by the delay, either cheques in the mail or direct deposit. We're still doing minor amounts of catch-up, but for all intents and purposes, we're back to normal.

**The Chair:** Thank you, sir.

We'll continue with Mr. Christopherson now. Six minutes, Mr. Christopherson.

**Mr. David Christopherson (Hamilton Centre, NDP):** Thank you very much, Mr. Chair. Thank you all again, good to see you again, as good as it can be for you to see one of your critics.

I wanted to pick up on your last point, the e-filing. Since we've got this opportunity and it's timely, can you tell us quickly what happened and what the assurances are that it's not going to happen again? It really did cause...I don't need to tell you that people were not impressed, and certainly my office was going crazy.

So perhaps you could give us a quick "what happened". What assurance do we have that private information was kept, that it won't happen again? What steps have you taken?

**Mr. William Baker:** Thank you, Mr. Chair.

This was a serious matter, there's no doubt about it. It did inconvenience Canadians and it prevented us from providing the quality and timeliness of service we aspire to provide and we take the matter very seriously.

The problem started on a weekend, March 4, when we were undertaking a relatively routine procedure, which is putting what we call a patch on our software. We do hundreds of these throughout the year. With the complexity of databases and information, you've got to keep updating and maintaining the system.

This one particular software patch, which was provided by an external supplier, had some improper code built into it, and that problem effectively created a situation where the connections between the databases was not occurring as it should. It was installed on Sunday. We detected the problem on Monday and we immediately took measures to contain the situation, which was to essentially freeze our application, so we wouldn't make the matter any worse.

I can assure the chair and members that at no point was any of the data corrupted by a virus or a hacker, so integrity wasn't an issue. We did have to go back through our records, though, and recover some of the data that was affected by this.

The specific problem that caused this outage has been fixed. We are in the process now, Mr. Chair, of conducting a more thorough post-mortem to see if there's anything different we could do before or during to try to ensure continuity of service.

Having said that, at the end of the day I think the most important thing we can do when presented with a situation like that is not make matters worse. The integrity of our databases is paramount.

The tax system affects 25 million Canadians. That's the number of returns we receive, and as you know, that database is relied on for the issuance of benefit cheques, and so on. So keeping that healthy was the most important consideration.

Will it ever happen again? This particular problem I don't think will ever happen again. Will there be other situations that cause us to have to shut down for a period of time? It's very possible. We're going to do whatever we can to mitigate those situations.

• (1130)

**Mr. David Christopherson:** I appreciate that. I appreciate that you understand how Canadians feel—how jarring it is, not just the inconvenience but also how worrisome it is that their information.... So thank you for answering that.

I want to go back to an issue we've talked about before. I know it's something the chair is apparently interested in, as I think he made comments on this the last time I raised it. I'm referring to the Auditor General's report of last month. What I'm looking for, or what my question will culminate in, is where in the estimates are the actions you've committed to take? The issue is international auditors' expertise in the Toronto offices, and I read from the Auditor General's report:

In our 2002 audit

—so not in this audit, but five years ago—

we expressed concern about the lack of adequately trained and experienced international auditors to undertake the complex audits of the international transactions of the largest corporations that involve transfer pricing and foreign affiliate issues. Our specific concern was that the audit approach and coverage across the country might be inconsistent, because of the relative inexperience of the international auditors in the four TSOs in the greater Toronto area (GTA). At that time, over one third of the international auditors in two of the GTA offices had less than one year of experience.

In 2002, we also pointed out that 40 percent of the large corporations that file foreign information returns reside in the GTA. We believed this indicated that significant international tax risk existed in these TSOs....

This means the Auditor General is concerned that money that ought to be coming into Canada from these large foreign corporations is not going to find its way here. This is big money.

This concern came out in the 2002 audit; it came out in this audit too.

I've had assurances from you in previous questioning. I'd like you to show me in the estimates where is the commitment to do something about this.

**Mr. William Baker:** Mr. Chair, there are a couple of elements in terms of response.

The budget that was just brought down on March 19 included, as I'm sure you're aware, some specific tax policy measures to address international taxation. They relate to the withholding of interest. There the whole issue of interest deductibility, which was an area where profits could be shifted offshore. As well, there were exchange of information agreements.

There was also in the budget—and perhaps not as prominent as other things—some additional money identified for the Canada Revenue Agency to increase its compliance activities, in particular in the area of international taxation. The total amount identified in the budget was \$50 million, beginning in the next fiscal year, for 2008-09. A good portion of that will be put toward increasing our level of effort on international taxation, because it's a growth area, frankly. More and more businesses are engaging in international transactions, and we have to try to stay on top of these.

Back to the situation in Toronto, I have a point of clarification. The observation of the Auditor General that people working in international taxation in the Toronto area had less than two years' experience—I believe those were her words—was about people who had less than two years' experience in the international taxation area. These are very seasoned auditors. It's not uncommon not to have a lot of years of experience in international taxation, because you only get to do international tax audits after you're a fairly mature and seasoned expert auditor.

With the additional money, we'll be able to increase our level of effort. In light of the Auditor General's report, and as indicated in our response to the report, we're also looking at opportunities to beef up the training and development of our auditors to fill that gap.

As I said on March 1, Mr. Chair, and I'll say it again, it will always be a challenge for the CRA to attract and maintain auditors at that level in the Greater Toronto Area because of the economic demands and competition we get from the private sector.

**Mr. David Christopherson:** Penny wise and pound foolish—

**The Chair:** Mr. Christopherson, your time is up.

We'll continue now with Mr. Pacetti, for five minutes, sir.

**Mr. Massimo Pacetti (Saint-Léonard—Saint-Michel, Lib.):** Thank you, Mr. Chairman.

I have a quick question, Mr. Baker. I want to go back to the point my colleague raised regarding the computer glitches. You've done a great job from a public relations point of view in terms of recovering. We don't see it in the news anymore; we saw it for the 10 days while we had the trouble. But we're still in the middle of tax season, so we haven't seen anything.

Why were only certain aspects of the processing affected, such as e-filing or electronic filing—and I think there was another electronic aspect, Internet filing, or something like that—and not whole department that shut down? Why was it only the individuals and not the corporate section?

• (1135)

**Mr. William Baker:** It's true, Mr. Chair, that it only affected tax processing of individuals, because the corporate tax systems and the GST systems are on separate systems or platforms. There's a limited amount of connectivity between the different systems, and those systems were not affected.

What became public was the difficulty people had in submitting electronically filed tax returns, but in fact, the problem affected our ability to process any kind of tax return, whether paper or electronic. So for that period of time, we were unable to do the normal keying in of paper returns, nor were our computers able to accept and process electronically filed returns.

**Mr. Massimo Pacetti:** I understand that the software Revenue Canada uses is complex, but did this have anything to do with these Mickey Mouse deductions that the government decided to store last year, such as the credit for public transit, or textbooks, and the.... ?

It's a valid question. We have a tuition fee tax credit that's going to generate perhaps \$15 for people, and transit taxes. This is just more information that's being accumulated in the software. All these changes are items that affect the tax return and the processing of tax returns.

Does that affect how Revenue Canada's system works?

**Mr. William Baker:** Mr. Chair, it is true that as tax changes are made, we have to make sure we can adequately incorporate them into our processing systems.

This particular problem had nothing to do with any specific tax measure. If I may explain, Mr. Chair, what we do once a year is essentially shut down our IT systems to program any new budgetary measures and any new tax rules into the system. That was done, I believe, in late January.

This particular problem was very specific to the functioning of the databases themselves, regardless of the tax measures they were designed to implement. So in this particular case, there was no—

**Mr. Massimo Pacetti:** I was just trying to help you there, to make you part of the process during the budget process, so that you can perhaps recommend to the finance minister, when he introduces these measures, that they actually cost taxpayers money instead of saving them money. It was a way for you to get some help, to get into the finance department and add some input. I was trying to help you out there.

**The Chair:** Of course, we all recognize here that the whole tax collection system costs taxpayers money. I think that's pretty much a given.

Mr. Pacetti, you have a brief moment left.

**Mr. Massimo Pacetti:** I'll wait until I have a third round.

[*Translation*]

**The Chair:** We will continue with Mr. St-Cyr.

**Mr. Thierry St-Cyr (Jeanne-Le Ber, BQ):** Thank you, Mr. Chair.

On the last page of your speech, you say that there will be a recovery of \$12 million from the Canada Pension Plan and EI account. Will those funds actually be reallocated to the EI account and CPP?

**Mr. William Baker:** As regards our activities in administering responsibilities related to EI and the CPP, we receive funds directly to cover our expenses. This sum simply reflects the fact that this type of work is being increasingly requested.

**Mr. Thierry St-Cyr:** That is how you bill the department that is responsible for employment insurance for the services you provide to it?

**Mr. William Baker:** That is essentially the case. Regardless, and with the permission of the chair, I wish to ask my colleague James to answer.

**Mr. Thierry St-Cyr:** Please go ahead.

[*English*]

**Mr. James Ralston:** I don't know whether you have before you page 4.4 of the estimates, but there's an interesting table there.

When we ask in the main estimates process for authority to spend, the amount we are seeking authority for, which in total turns out to be \$3.379 billion this year, does not in fact reflect all of the spending we will undertake. In addition to that amount, we will spend another estimated \$163.9 million related to the CPP and EI functions we undertake.

The particular \$11.6 million item you refer to is to reflect the fact that when, for example, we have another amount, which we indicated was \$99 million that we were asking for in respect of collective agreements, and there was a certain amount reflected in respect of the administration of the student loans program.... Included in those other amounts was the \$11.6 million, and we broke it out in order to avoid double counting.

• (1140)

[*Translation*]

**Mr. Thierry St-Cyr:** All right, thank you.



These days, people are able to buy software that can produce and analyze income tax returns, and submit them electronically. To my knowledge, this cannot be done free of charge, however. If I am mistaken, please let me know. For those who fill out their tax return manually, as I continue to do, an electronic copy of the tax return cannot be found on the Internet, and therefore cannot be submitted electronically.

Is this correct? Is there a free service? If not, do you intend to provide free service? In my opinion, this would be a good idea. You would not be competing with private companies who process, analyze and manage data. People would then be able to file their returns electronically, free of charge. That would save you from—

**Mr. William Baker:** For now, we have no intention of doing so. Software provided by the private sector costs between \$6 or \$7 to \$40. However, pursuant to agreements we concluded with the private sector, approximately 60% of low-income earners have access to the software free of charge.

[English]

There are now 14 companies in Canada that provide electronic filing software. They've been in business since the 1980s. It's a vibrant business, and it's not our intention at this time to replace that, given they've agreed to ensure that lower-income Canadians, and in fact 60% of Canadians, have free access to this software.

I might add that any Canadian can also file using Telefile free of charge. We also provide a very robust community volunteer program for immigrants, senior citizens, and Canadians in need for whatever reason, which can help people file. They use electronic filing, and that's available free of charge.

[Translation]

**The Chair:** Thank you.

[English]

Thank you, Mr. St-Cyr.

Mr. Dykstra is next for five minutes.

**Mr. Rick Dykstra (St. Catharines, CPC):** Thank you, Chair.

I'm a little concerned about my good friend Mr. Pacetti, who seems to want to increase taxes on the folks who probably need money the most—those using transit. It's a big concern. It's probably something he regrets and wants to take back.

I want to ask a couple of questions to get a broader understanding of the appeals process and what exactly we fund under it. I notice it has jumped by about 14%. I know that Mr. Wallace asked about it, but I'd like an overall understanding of it.

**Mr. William Baker:** Any taxpayer, whether it's an individual or a business, assessed by the Revenue Agency has the option to contest that assessment for whatever reason.

We've had the process for many years, and the first step is an internal process through the appeals branch. This is part of the Revenue Agency, but it has complete independence, which allows it to take an objective look at any decision the agency has taken and review the facts. That group resolves on average about 95% of all the disputes it receives. It's a well-functioning unit. It has been modelled

across the world, and is provided at no cost to taxpayers, unless of course they choose to be represented by an accountant or a lawyer.

If they're not satisfied with the decision from the appeals branch—the administrative redress process—their option is to file an appeal with the Tax Court of Canada. That's a special court in Canada that exists just to deal with tax matters. It's very professional. You can appeal a Tax Court decision to the Federal Court of Appeal and ultimately seek leave from the Supreme Court. That is the mechanism we employ to deal with disputes.

• (1145)

**Mr. Rick Dykstra:** When you use that, I'm assuming the purpose of the cost recovery is from an internal perspective. We don't generally cover the costs for those who file appeals.

**Mr. William Baker:** That's correct. There is not a charge to have your file reviewed by the appeals branch. We consider this an integral part of providing service to Canadians.

**Mr. Rick Dykstra:** Just out of interest, what did you say the percentage of successful appeals was?

**Mr. William Baker:** We resolve, at the appeal stage, about 95% of our disputes. Now, I should say that some people may not be totally satisfied but are reluctant to go to court for whatever reason, but we also have at the Tax Court something we call an informal procedure that is for amounts under a certain threshold—I don't know what it is. It's designed to pick up most individuals and small businesses even, and that's included in the number that go downstream, so it's very small.

**Mr. Rick Dykstra:** This relates not so much to the point that Mr. Christopherson made with respect to the Auditor General, but more speaking to the longer term, the work that you've done on the vision, focusing on where you're going to go as an organization and relating that to trying to achieve some cost savings. I know we talked about that overview earlier in the term, but later last year, 2006.

One of the issues I've run into and a number of my colleagues have mentioned to me as well is the issue of changing the process in a local community in terms of not being able to actually go and speak to somebody now. I know there were some cost savings tied to that. How has that gone?

Speaking from the perspective of the riding in St. Catharines, it hasn't gone very well. I'm wondering if there's still internal review and work being done on it.

**Mr. William Baker:** Mr. Chair, I think the specific measure you're referring to is the decision to move from walk-in service to a by-appointment service only. This was done for three reasons.

First of all, the number of people wishing to walk into our offices for answers has declined over the years. More and more people are comfortable getting answers via the telephone or on the Internet, and that's just a modern way of doing business. We encourage it because it's actually more efficient, it provides a more precise answer, and it is cheaper to administer for taxpayers.

The other factor is that we've found that those issues that do require service at the counter are increasingly complicated, and the idea of having somebody walking in, speaking to one of our client service officers and getting all the answers at that point in time is increasingly unlikely. So we ask people now to call, let us know the nature of the issue that they wish to discuss, and we'll gladly arrange an appointment for that person to come in. We've also found generally that people are very satisfied with our telephone and online services, so we're confident.

It is an adjustment; I don't deny that. Any time the agency changes anything, because we affect so many people, it takes a bit of getting used to. But I believe this is a wise way forward for the evolution of the agency.

**The Chair:** Thank you, Mr. Dykstra.

Mr. McKay.

**Hon. John McKay (Scarborough—Guildwood, Lib.):** Thank you, Chair.

Mr. Baker, a friend of mine, a well-known lawyer—you'd probably recognize his name if I mentioned it—used to make something of a living going around the charitable circuit, primarily Christian charities, and he used to explain the new rules or try to explain the new rules for charitable compliance to a variety of groups, whether they were church groups or NGOs, or in some cases non-Christian charities, etc. He lobbied hard and long with the Department of Finance to try to get them changed so that there was some simplification so people wouldn't err inadvertently and fail to comply because they either didn't understand or misinterpreted the rules.

He was notable in his lack of success in terms of changing the rules, and so now I assume your agency is stiffed with trying to interpret these rules or at least force compliance by these charities, of which there are quite a number. There are literally thousands of charities that you have to deal with.

So I would like to know from you, from your perspective, the experience that you've had with these new rules and what measures, if any, are in place with respect to compliance errors that are largely innocent errors.

• (1150)

**Mr. William Baker:** If I may, Mr. Chair, we have over 80,000 registered charities in Canada today—that is, they are registered as charities under the Income Tax Act. The approach we take with charities with respect to compliance with the rules, I think, recognizes the important role they play in Canadian society. Often,

as well, charities are not being run by large boards of directors that have sophisticated knowledge and expertise.

We're doing a few things. First of all, if we determine that there's a compliance problem with a charity, we don't tell them in the first instance that they're offside and therefore no longer eligible to derive the benefits of being a charity. We would get in touch with the charity and let the charity know the issue we've identified and find a way that resolves it.

There was reference earlier, in fact—and I'll just highlight it in the main estimates—to charities regulatory reform, which was announced in budget 2004. As Mr. Ralston explained, this was also designed through outreach to provide more education and support to charities to help them comply with the requirements under the Income Tax Act as they affect charities.

**Hon. John McKay:** What's been your experience to date?

**Mr. William Baker:** The outreach program is still in its early stages, and in fact, we're seeking money through the main estimates to expand that.

**Hon. John McKay:** Is this the first year in which they'll have to comply with the new rules, or is it the second?

**Mr. William Baker:** The changes announced under charities regulatory reform were in the 2004 budget.

**Hon. John McKay:** So that would be the 2005 and 2006 cycles, so this would be the second year.

**Mr. William Baker:** That's right. It should be, I think, the second year, Mr. Chair. I could confirm that.

**Hon. John McKay:** Is there a pattern of any egregious anomalies that have resulted in the first year's filings?

**Mr. William Baker:** I'm not aware of any pattern. There are and there have always been certain charities that run into difficulty. As I said, we work with the charity to try to bring them onside.

**Hon. John McKay:** I agree with your comment that a lot of these charities are not run by sophisticated people, or if they are sophisticated people, they are doing it on volunteer time. And there is a cost-benefit analysis that goes with this sort of thing. People join charities to do good work; they don't join charities to spend their evenings trying to comply with absurd rules from Revenue Canada.

**The Chair:** We'll continue now with Madame Ablonczy.

**Ms. Diane Ablonczy (Calgary—Nose Hill, CPC):** Thank you, Mr. Chairman.

My colleagues have covered a lot of ground. You said in your remarks that CRA's 2007-08 main estimates are seeking an increase of some 4.7%. I wonder if you could tell us how that would relate to increases in previous years.

**Mr. William Baker:** With the permission of the chair, I'm going to ask Mr. Ralston to talk about previous years, please.

• (1155)

**Mr. James Ralston:** What I could say is that typically, year over year, changes are somewhat unique. There are some common features. If collective agreements have provided for salary and wage increases, for example, those will be reflected. There will be, however, a lot of items, as we talked about, that are reflective of budgetary changes that new measures need to be provided for. That is a big determinant of the level of activity from one year to the next, and it would just depend on how much we've been impacted in those cases. Certainly, the changes this year and in the last couple of years have been heavily influenced by reduction measures—the expenditure review, procurement reform, and things of that nature—which, as I say, tend to dampen increases. It's very hard to generalize.

**Mr. William Baker:** Perhaps I might add to this, Mr. Chair. My apologies, that's a fair question, and I should have been able to give you the year over year. We'd be pleased to provide that to the committee.

**Ms. Diane Ablonczy:** I think that would be helpful. I do note that two-thirds of what you're asking for today is with reference to collective agreements—wage settlements.

The only other question I have is whether these estimates include hiring more staff, and if so, how many.

**Mr. William Baker:** When you look at what's in the increase areas, the only area I can identify where there would be some additional staff is that there is an amount of \$18.5 million related to the ongoing implementation of previous budgetary measures. Some portion of that would be related to salaries.

To put this in perspective, for the agency as a whole, around 76% of our total budget is related to salaries, and about 81% of the operating part of our budget is related to salaries. One could reasonably assume—and again I could give you more precision—when we have to increase our level of effort to administer a new tax or greater increased audit activities or whatever, on average 75% or 80% will be directed toward staff.

**Ms. Diane Ablonczy:** Okay. That's helpful.

Thank you, Mr. Chair.

**The Chair:** Thank you very much.

We'll conclude with Mr. Pacetti for a couple of brief questions.

**Mr. Massimo Pacetti:** Thank you, Mr. Chair.

Mr. Baker, if I compare the main estimates for this year to the total estimates after the supplementary estimates, the total for 2006-07 was \$3.467 billion. So this year you're asking for \$3.3 billion. Shouldn't they be looking at the \$3.4 billion versus the \$3.3 billion, instead of the \$3.2 billion?

**Mr. William Baker:** Mr. Chair, I will ask Mr. Ralston to respond with your permission.

**Mr. James Ralston:** It's because of the remark I made earlier, that the increases that are due to supplementary estimates tend to affect only that year and that year only. They don't roll over automatically. So the end number, if you will, after supplementary estimates, doesn't automatically become the new opening number.

So that's why we tend to focus on—

**Mr. Massimo Pacetti:** No, I understand, but nothing in the \$35 million is recurring from the supplementary estimates?

**Mr. James Ralston:** Very little of it, in point of fact, is reflected in the mains, but as I said in my earlier remark—

**Mr. Massimo Pacetti:** It will just be reflected in the next supplementary.

**Mr. James Ralston:** In the next supplementary, and the next mains after that.

**Mr. Massimo Pacetti:** My final quick question is this. In your opening remarks, Mr. Baker, in one of your last bullet points you say “an increase of \$18 million for children's special allowance for statutory payment”. If I do the calculation, \$21 a month for 65,000 recipients for 12 months, that means you're going to pay out \$16 million for something that costs \$18 million.

**Mr. James Ralston:** That amount, the \$21, was an increase over the previous amount. So they receive more than \$21.

**Mr. Massimo Pacetti:** Yes, but the additional benefit of \$21 for 65,000 recipients for 12 months is \$16 million. The increase of \$18 million just doesn't—

• (1200)

**Mr. William Baker:** Once again, I'll ask Mr. Ralston to give you that precision.

**Mr. James Ralston:** I think part of it is just due to rounding. The actual—

**Mr. Massimo Pacetti:** You can round up. You can round \$16 million to \$17 million.

**Mr. James Ralston:** —increase was \$20.83 per person, and that raises the total amount paid to \$266.66, and the actual number of recipients is 64,654. So I think it's the rounding.

**Mr. Massimo Pacetti:** That's fine, but that \$18 million is for the benefit itself?

**Mr. James Ralston:** Yes.

**Mr. Massimo Pacetti:** It is not the cost to implement. Okay, that was the question.

**Mr. William Baker:** If I might explain, these are children in institutions who would otherwise, if they were at home, be getting the child tax benefit.

**Mr. Massimo Pacetti:** I understand. I just thought it was a cost of \$18 million to pay out \$16 million.

**Mr. James Ralston:** No.

**Mr. Massimo Pacetti:** Okay. Thank you, Mr. Chair.

**The Chair:** *Merci beaucoup, monsieur.*

Thank you for being here again. It is nice to see you again, and we'll let you get back to the business of collecting those taxes on behalf of Canadians.

We'll recess just briefly and ask the Office of the Superintendent of Insurance to come forward now.

- \_\_\_\_\_ (Pause) \_\_\_\_\_
- 
- (1205)

**The Chair:** Pursuant to Standing Order 81(4), main estimates 2007-08, vote 30 under Office of the Superintendent of Financial Institutions—which I mistakenly earlier referred to as the Office of the Superintendent of Insurance, which was a reflection of my previous existence in the private sector, and I do apologize for that—referred to the committee on Tuesday, February 27, 2007, I call vote 30.

Madam Julie Dickson is with us.

I welcome you and your associates to the committee and invite you, if you wish, to make some opening comments.

**Mrs. Julie Dickson (Acting Superintendent of Financial Institutions, Office of the Superintendent of Financial Institutions Canada):** Yes. Thank you, Mr. Chair and members of the committee. Good afternoon.

The Office of the Superintendent of Financial Institutions was created to contribute to public confidence in the Canadian financial system. Canada's robust regulatory regime has assisted in creating one of the strongest financial systems in the world. The strength of this system is critical for continued development and innovation in our economy and in protecting the savings of Canadians. Therefore, maintaining our status as a world-class prudential regulator is an OSFI priority.

[*Translation*]

OSFI is mandated to supervise institutions and pension plans to determine whether they are in sound financial condition, and are complying with their governing law and supervisory requirements. In the event we perceive any material deficiencies, we advise institutions and require them to take necessary corrective measures. OSFI also monitors system-wide or sectoral issues that may have a negative impact on institutions, and we advance and administer a regulatory framework that promotes the adoption of policies and procedures designed to control and manage risk.

[*English*]

Canadian financial institutions are operating in an increasingly complex international environment. To meet its mandate, OSFI must

monitor Canadian institutions' ability to manage the risks of operating in this environment. OSFI's priorities for the coming year and beyond build on our commitment to world class regulation.

OSFI's major priorities for the current planning cycle include Basel II implementation for banks, an assessment of Canada's financial system by the IMF and the World Bank, an assessment of Canada's anti-money laundering and anti-terrorist financing regime by the Financial Action Task Force, an in-depth review of life insurance capital rules, the adoption of international accounting rules in Canada, pensions, internal systems and processes, and readiness planning.

OSFI's costs of regulation and supervision are almost fully recovered from the industry. As well, CIDA currently funds approximately \$1.3 million of our annual costs for the assistance that we provide to foreign supervisors through our international advisory group. The costs of the Office of the Chief Actuary are largely funded by the organizations for which it does actuarial work. An annual appropriation of approximately \$780,000 covers the actuarial services the OCA provides to various public service pension plans.

OSFI's overall costs will rise by 6.5% between 2006-07 and 2007-08. The increases are due to normal inflationary and merit adjustments and continued technology investments related to the implementation of the Basel II Capital Accord, and to support our monitoring of private pension plans.

OSFI's accountability framework has a variety of elements. Our internal audit group conducts assurance audits based on a comprehensive five-year risk-based plan. Audit results are reviewed by OSFI's executive and the audit committee at regularly scheduled meetings.

OSFI strengthened its internal audit program considerably in 2006-07 in accordance with the new Treasury Board audit policy. Effective the first quarter of 2006, OSFI appointed four external members to its audit committee who serve with the superintendent. The independent members represent a majority of the committee.

Internationally, as mentioned previously, OSFI participates in reviews jointly held by the World Bank and IMF to determine whether we are meeting internationally established principles for prudential regulators. We also regularly conduct anonymous surveys of knowledgeable observers on our operations.

We consult extensively on our regulatory rules before they are finalized. We issue an annual report, and our financial statements and related control processes are audited annually by the Auditor General of Canada. We also discuss our budget with financial institutions and pension plans every spring.

•(1210)

[*Translation*]

OSFI's mandate, coupled with the powers provided to it by Parliament, has gone a long way in contributing to a safe and sound financial system in Canada. But we are always mindful of the fact that the financial services sector is dynamic and ever-changing. OSFI will continue to do its part to maintain and further develop a strong prudential regulatory regime that will have the confidence of all Canadians.

[*English*]

I would be pleased to answer any questions the committee might have.

Thank you.

**The Chair:** Thank you very much, Ms. Dickson. We appreciate that.

We'll begin our questioning with Mr. McKay, for six minutes.

**Hon. John McKay:** Thank you, Chair.

On federally regulated pension plans, anecdotally and evidentially my recollection is that something in the order of at least 50% of them aren't meeting OSFI standards. Can you give us, in general terms, an analysis of the state of pension plans that are federally regulated?

Secondarily, part of the problem has to do with their reserves, what reserves they need to set aside in order to fund, and it's all based on ratios, which only actuaries and accountants actually understand. Is there any movement afoot to deal with those ratios and lessen that burden in order that more plans can be brought into compliance?

**Mrs. Julie Dickson:** First of all, there might be some confusion about how many plans are in compliance versus how many plans have a deficit that they are paying off. Most of our plans are in compliance.

The issue is that last year we reported that three-quarters of the pension plans had a deficit, which means that they have to fund that deficit over a five-year period. That was a relatively new development. Prior to that, a few years ago, most plans were even or in surplus.

Currently, the health of the stock market last year has had quite a positive impact on pension plans. While I don't have the final results for the year 2006 yet—I will have those in a few weeks—early indications are that many of our plans are back into an even situation, meaning they would not have these deficits that they have to pay off over five years, and that is due to the strong stock market returns.

On your other question, about actuaries and accountants, accounting rules are the purview of the Accounting Standards Board, but they are announcing some changes that would have an impact. Those changes would suggest that if you're a corporation with a pension plan that has a deficit, the deficit should go on the balance sheet of the corporation, as opposed to being in the notes. That's one current development.

We continue to talk to the actuaries about their rules, because they made a major change a few years ago that has had an impact on how you calculate what pension plans owe. We continue to talk to the actuaries about that to see whether they might go in and look at revising that in the future.

**Hon. John McKay:** That's an interesting idea, moving the pension plan deficit from notes at the back of the statement onto the balance sheet itself. Presumably that could move a corporation from a profitable year to an unprofitable year, and in turn, therefore, affect the stock price of the corporation, and in turn, affect the assets of the pension plan, which would be holding some of that corporation's stock.

It creates a bit of a perverse cycle, wouldn't you think?

•(1215)

**Mrs. Julie Dickson:** I guess it depends. At the end of the day, corporations that are affected by this will have an opportunity to provide their views to the Accounting Standards Board.

Some people might say the information is in the notes to the financial statements, so if it goes onto the balance sheet, rating agencies that might be looking at the corporation read the notes, and if this change goes through, they'll also see it on the balance sheet of the corporation. There could be a difference in those two scenarios in terms of how the market looks at the corporation. That's beyond my expertise, but it is an important issue, and corporations that are affected should be talking to the Accounting Standards Board.

Under the pension rules, I don't think pension plans are allowed to invest heavily in their own shares. That is something we would keep a close eye on.

**Hon. John McKay:** You said the stock market has basically taken about a 75% deficit rate and zeroed it out. Is that fair? This is good for this year, and of course last year was an amazing year on the stock market.

How can rules or regulatory agencies like yours, in effect, lock in that positive balance and cut down on the downside of going back into deficit when the market turns down?

**Mrs. Julie Dickson:** I think the recent experience of pension plans has led many companies to take a good look at the risks they are running with the pension plan and to better manage it. For sure, it is good news, as you know, that the stock market returns have had a positive impact on pension plans. The stock market can go like this. It can be volatile. Interest rates can increase and can decrease, and that also has a major impact on plans.

We would be encouraging people to increase their ability to manage risks in those plans, be very aware of how much risk they are taking, and manage that risk so people aren't surprised in the future if stock market returns don't turn out the way they hoped they would turn out.

[*Translation*]

**The Chair:** Thank you. The floor now goes to Mr. Paquette.

**Mr. Pierre Paquette:** Thank you, Mr. Chair.

Thank you for your presentation. My first question is on the Basel II Capital Accord and the funds allocated to implement it. In general terms, can you remind us what the accord is about, and tell us how the office intends to assist banks in adhering to the accord. In your statement, you mentioned that the Office of the Superintendent of Financial Institutions will work closely with the banks in the coming year as implementation of the Basel II Accord moves forward. I would have liked to know, in concrete terms, how exactly the office will work alongside the banks. And please remind us, if you will, of what the Basel II Accord is about.

[English]

**Mrs. Julie Dickson:** The Basel II accord is an international agreement among bank supervisors to change the way capital requirements are developed and calculated for banks. Up to this point in time, all banks had the same rules, called Basel I. They were not very risk-sensitive, so that if the bank was lending to a corporation that was rather weak or a corporation that was really strong, the capital charge was the same for both. Under Basel II, a lot of work has gone into developing more risk-sensitive requirements. A lot of mathematics goes into this.

In addition, there were a lot of requirements that banks have a lot more data to look at the types of risk they take, and there were more requirements for boards of directors and managers to have more information about how the bank is performing when it makes loans.

In terms of OSFI's role, we had to create a number of new systems so that we could receive a lot more data from the institutions, and we could slice and dice it to look at what was really happening and to come to some understanding with the banks as to what each bank's capital level ought to be. It's fairly important, because going forward under this new regime, some banks may have to increase their capital and some banks might see a decrease in their capital. That's a fairly important thing.

All of our work now is designed to ensure that we understand each bank's system, how they're coming up with their numbers, so that we can make a final determination as to whether their capital levels at the end of the day are acceptable.

• (1220)

[Translation]

**Mr. Pierre Paquette:** You also mentioned in your speech that you recover most of your expenses from financial institutions' revenues. Is this done through a billing system for services provided by the office? How does it work exactly?

[English]

**Mrs. Julie Dickson:** In regulations there are formulas set out that are basically based on size of institution, so for a large bank, you look at their total assets and you take OSFI's costs, and the formula will tell you how much of those costs the banking industry will pay, how much of the cost the insurance industry will pay, how much of the cost the pension plans will pay, and—

[Translation]

**Mr. Pierre Paquette:** Yes, go ahead.

[English]

**Mrs. Julie Dickson:** —then we send a bill to the financial institutions, which they must pay. We do meet with the institutions at

least once a year to talk about our costs. We meet with the industry associations frequently, but we do have meetings where we explain our costs, why they've increased, and what they might expect down the road, because they of course keep a close eye on our costs, given that they pay the bills at the end of the day.

[Translation]

**Mr. Pierre Paquette:** I assume that the 6.5% increase in costs, which is considerably higher than the rate of inflation, must have drawn the attention of banks, did it not?

[English]

**Mrs. Julie Dickson:** We will be meeting with the banks next month to talk about the 6.5% increase. Part of that increase reflects the fact that we did not spend as much money last year as we told them we would spend. We had a number of vacancies, particularly in the Toronto office, which we're now moving to fill, which contribute to the 6.5% increase in costs this year. The Basel II they're fully aware of. They've been aware of that since day one, because we've communicated with them a lot about our costs on the Basel II front.

As well, they are paying for some additional resources in areas like anti-money laundering and accounting, which are big issues in the banking sector now. And they will be paying for enhanced governance at OSFI, so they will end up paying for the audit committee that we have created and the internal audit unit that we have staffed up as well.

[Translation]

**Mr. Pierre Paquette:** I would have one last question, Mr. Chair. Do I have any time left?

**The Chair:** Sorry, Mr. Paquette, you do not. We will continue with Mr. Wallace.

[English]

**Mr. Mike Wallace:** Thank you, Mr. Chairman.

I'm going to stick to the estimates. I appreciate the overview of some of the work that the organization does, but I want to be clear. Your document to us talks about a 6.5% increase, but in the actual estimates, it's got a 2% increase. Can you explain for me what the difference is there, why it's different?

**Mrs. Julie Dickson:** Because OSFI is funded primarily by financial institutions and pension plans, the appropriation is a very small number, and it's only for the Office of the Chief Actuary, so the appropriation number you see in there is only for the Office of the Chief Actuary, which is housed within OSFI but is independent.

**Mr. Mike Wallace:** Okay, so the two points that you're looking for is actual tax dollars.

**Mrs. Julie Dickson:** Yes.

**Mr. Mike Wallace:** The rest that makes up the difference is paid for by the organizations that you do work for, basically. Is the 6.5%, year over year, actual or is that budgetary?

**Mrs. Julie Dickson:** It's budgetary.

**Mr. Mike Wallace:** Okay, so based on last year's budget, what was your actual? Were you below?

• (1225)

**Mrs. Julie Dickson:** Yes, 1.4% or 1.6%.

**Mr. Mike Wallace:** So you were close, but you were underneath.

**Mrs. Julie Dickson:** Yes.

**Mr. Mike Wallace:** And then the increase you're looking at this year—I think you just explained it but I want to be clear—is because.... I'm assuming most of your fees or your costs are staffing

**Mrs. Julie Dickson:** Yes, primarily.

**Mr. Mike Wallace:** —and there were vacancies, and they're being filled in this calendar year, thus they have to be reflected in this budget.

**Mrs. Julie Dickson:** That's exactly it.

**Mr. Mike Wallace:** Were those positions reflected in last year's budget, or did you reflect them in the budget as empty, as not filled?

**Mrs. Julie Dickson:** Those were positions in the budget, but they were empty last year.

**Mr. Mike Wallace:** Okay, so of the 1% that you're underneath your budget, from actual to budget, that budget of last year included those positions being filled?

**Mrs. Julie Dickson:** Do you want to respond to that, Michèle?

**Ms. Michèle Bridges (Director of Finance, Finance and Corporate Planning Division, Office of the Superintendent of Financial Institutions Canada):** The positions were factored into our budget. We also factor into our budget an expected vacancy rate. We anticipate a certain level of turnover, and that turnover level exceeded our planning assumptions.

**Mr. Mike Wallace:** All right; that's good.

You haven't actually met with the organizations that pay the majority of this increase. Does that happen in the next little while?

**Mrs. Julie Dickson:** Yes, but we meet with them every year and we give them a three-year projection as well.

**Mr. Mike Wallace:** Is this accurate to last year's projection? Do they understand that this is coming?

**Mrs. Julie Dickson:** Yes.

**Mr. Mike Wallace:** Okay.

Those are my questions, Mr. Chair.

**The Chair:** Thank you, Mr. Wallace.

Would you like to briefly overview for the committee how your revenues are derived, from which category of institution—not in incredible detail, but just as a bit of an overview?

**Mrs. Julie Dickson:** You're asking from which category of institution?

**The Chair:** That's correct, yes.

**Mrs. Julie Dickson:** We will have revenues from the banks as one category, revenue from life insurance companies as another category, revenue from property and casualty insurance companies, revenue from pension plans. The Office of the Chief Actuary's revenue would not only come from appropriations; he has memorandums of understanding with various departments for the actuarial work he does, and revenues also from CIDA for the international training we do.

Have I missed any source?

And there are surcharges.

**The Chair:** Roughly what percentage comes from banks?

**Ms. Michèle Bridges:** We receive approximately 55% of our costs as recoveries from the banks.

**The Chair:** And from life insurance companies?

**Ms. Michèle Bridges:** I would say it's probably about 20%.

**The Chair:** And from property and casualty?

**Ms. Michèle Bridges:** It's about 11% or 12%.

**The Chair:** Okay. Thank you.

Madam Wasylycia-Leis, welcome back, and it's over to you.

**Ms. Judy Wasylycia-Leis (Winnipeg North, NDP):** Thank you very much.

Thank you for appearing before us, and congratulations, Ms. Dickson, on your responsibilities to fill in on this file for now.

Can you indicate when the permanent position will be filled?

**Mrs. Julie Dickson:** The order in council is a six-month order in council, which can be extended.

**Ms. Judy Wasylycia-Leis:** Are you enjoying it?

**Mrs. Julie Dickson:** I'm loving every minute of it.

**Ms. Judy Wasylycia-Leis:** I'm glad to hear that, and it's nice to see all women up front here on financial issues.

Since my colleague Mike Wallace has asked a lot of in-depth questions on estimates, I'm going to go to a couple of current issues for which I think OSFI has a role. The first has been in the news quite a bit lately and has to do with conversion fees.

Of course, you know that it used to be that if I had an RRSP and invested in U.S. bonds that matured and I wanted to reinvest that money, I'd have to pay to convert from U.S. to Canadian currency and then pay again to convert back into U.S. currency, but that was supposed to have changed on June 14, 2001. However, it's clear that some financial institutions are continuing to charge those fees without the consent of their clients. It's been very much in the news, as recently as March 24.

I'm wondering what you have done. What has OSFI done to investigate the situation, what have you found out, and what can you do about it?

•(1230)

**Mrs. Julie Dickson:** Certainly, OSFI will read articles about things like that, because we are interested, but under our mandate we are to focus on safety and soundness. So we look for things that, if not corrected, could have a profound impact on a bank's safety and soundness.

When issues like this come up—issues concerning fees charged by banks to consumers—we look at those issues with interest, but we don't do anything further than that, because it would be our sister agency or other agencies that would look at—

**Ms. Judy Wasylycia-Leis:** Which agency would look at that?

**Mrs. Julie Dickson:** The Financial Consumer Agency of Canada has an education role and a role to look at the consumer provisions of the act.

**Ms. Judy Wasylycia-Leis:** I appreciate that, but if you have a situation where financial institutions like the Bank of Montreal—and there's a lawsuit going on—actually continue to process the conversions and charge the clients the conversion fees, notwithstanding the law and without telling the clients, it's not an FCAC responsibility but a government responsibility, or, I would think, OSFI's, given your role to maintain public confidence in our financial system.

Somebody has to be responsible for this, and if it's not the consumer agency—and it can't be—it must be you, or somebody.

**Mrs. Julie Dickson:** I can tell you that I know it's not OSFI.

**Ms. Judy Wasylycia-Leis:** Who is it, then?

**Mrs. Julie Dickson:** I would start by asking questions to the FCAC, but on this whole front—

**Ms. Judy Wasylycia-Leis:** They respond to consumer complaints; if a consumer doesn't know until way too late....

You're dealing with big banks, with huge power, up against individuals. Isn't there something OSFI can do to require the banks to uphold their fiduciary responsibility?

**Mrs. Julie Dickson:** No, we wouldn't have any direct powers to deal with something like that. We are constantly dealing only with safety and soundness, which is a consumer protection thing as well. It is a full-time job on its own, and we don't have the powers to deal with those situations.

**Ms. Judy Wasylycia-Leis:** Well, then we're missing something important in terms of the whole government infrastructure around holding banks to account for the laws that exist.

Did OSFI investigate once you heard about this? Did you do anything?

**Mrs. Julie Dickson:** No, that would be part of.... I'm interested in reading any article that appears with respect to a bank, because I think it's important to know what's going on in the sector, and when issues come up, OSFI is always asking whether we have a role to play. On this one, we definitely do not.

**Ms. Judy Wasylycia-Leis:** Let me try another issue. Again it's going to be in that grey area about your role, but maybe you can comment on it. It's on the issue of retroactivity when you apply for your CPP.

Right now CPP limits your ability to get retroactive payments to 11 months; the Quebec Pension Plan doesn't. Can you tell me if there any kind of fiduciary reason, any kind of accounting reason, that people couldn't be entitled to their own pension, no matter how long it took them to apply for it?

**Mrs. Julie Dickson:** No, I wouldn't be well placed to answer that question. It's not something that falls under my mandate.

**Ms. Judy Wasylycia-Leis:** Could you tell us if there's any kind of actuarial reason for this kind of situation?

**Mrs. Julie Dickson:** There isn't that I'm aware of, but I wouldn't profess to be an expert on that. I know that obviously the Office of the Chief Actuary looks at CPP and provides actuarial views, but I don't know the specific answer to your question.

**The Chair:** Thank you very much.

For clarification, would it be fair to say you exist to protect the consumer in the sense that your office exists to protect the financial stability of the institutions that offer services to the consumer?

**Mrs. Julie Dickson:** That's exactly it.

**The Chair:** Okay, so on consumer complaints and so on, we might suggest the ombudsman for banking services or an office like that would be better equipped to deal with consumer-specific concerns.

I want to segue off Madam Wasylycia-Leis's general inquiries to the issue of sub-prime mortgages. I wonder, given the circumstances in the United States right now and the recent entry into the field of sub-prime mortgages in Canada of non-traditional issuers of mortgages, where that sits right now with your office. Will you be collecting a levy from these companies now entering the marketplace and offering sub-prime mortgages? Is that something you will be doing?

•(1235)

**Mrs. Julie Dickson:** We've been monitoring closely what is going on in the U.S. We don't see the same conditions here at all. The U.S. market is much more developed than the Canadian market. The Canadian market is growing rapidly, but has only started to grow over the last few years. Institutions and unregulated players in the U.S. have been doing this for quite some time. It's probably 2% of the Canadian mortgage market, and it's closer to 15% in the U.S. We don't see much activity in new originations. It may be 5% here; it's closer to 20% in the U.S.



A few institutions are very interested in this, small institutions, and some unregulated players in Canada are interested in this market. We would, as part of our job, be looking at what those institutions are doing. The U.S. market is giving us lots of examples of what to look at. We're not seeing the exotic mortgages; we're still seeing 25-year amortization with three- to five-year fixed terms. Also, in the U.S. the interest deductibility of interest payments when you have a mortgage is a big driver to borrow more than you would borrow here.

Mortgage insurance is playing a big role in Canada as well; all the high-ratio mortgages must be insured if they're offered by a bank. Predominantly the lenders are regulated institutions in Canada. There are new players—

**The Chair:** Just to back up to the simple question, from these companies that are now in an industry component that is in its infancy, will there be a levy collected by your office; and are they under the auspices of your office? In other words, do you offer oversight to this component of the industry?

**Mrs. Julie Dickson:** If it's a federal institution, yes.

**The Chair:** Okay, and you've alluded to the fact that there are some non-regulated and non-affected potential issuers. But it is an area with great potential for growth, as has been testified to before our committee, and also an area where obviously, by its nature, these kinds of mortgages are somewhat more affected by increases in interest rates, that type of thing. That's why I'm asking.

Apart from observing the U.S. situation, what other research or preparatory work have you done in respect of these? I do believe from testimony we've heard at the committee that there is the potential for a great expansion in the marketplace of those types of mortgages, which prior to this time have not been utilized by Canadian homeowners. What kind of work have you done in respect of this?

**Mrs. Julie Dickson:** Any time we see a line of business growing rapidly in a financial situation, we look at it. This is a line of business that in the past few years, we noticed, had started to grow rapidly but off a very small base.

We have been spending more time looking at that, as we would any line of business that starts to grow rapidly. That is the answer. We've been looking more closely at it. We're still fairly comfortable, because it is rapid growth but you don't see the kinds of exotic mortgages being offered here that are being offered in the U.S. So it is a different situation, but one that we're watching closely.

**The Chair:** Finally, from my standpoint for questions, in terms of the most recent budget, it makes reference to the—I hate to use the word—liberalization in terms of access to various investment vehicles in Canada, international vehicles that may be more available on a retail level. What impact do you see in changes in respect of investment options being expanded, perhaps greatly, for the Canadian consumer?

Also, more importantly, I suppose, for financial institutions, pension plans and the like, what impact do you see that having, if any, on your work and in terms of the oversight that you must offer to some of these institutions?

• (1240)

**Mrs. Julie Dickson:** I don't see a major impact just yet. One proposal talked about being able to buy securities, if you're in Florida, using a broker in Florida, and that kind of thing, which doesn't have an impact on OSFI, given that we're looking at federal financial institutions and we're not responsible for the activity whereby you're selling securities, etc. That would be in a securities dealer, which would be overseen by securities commissions. So I don't see anything there for us.

**The Chair:** Finally, on the issue of the reference to the changes in terms of eligibility for deductibility for investment in foreign tax havens, as some call them, recent news coverage has had the banks certainly crying foul and saying this has a considerable negative impact on them potentially, and specifically them. I wonder if you foresee this as being a major issue of some import in terms of the stability of financial institutions such as banks in Canada.

**Mrs. Julie Dickson:** All tax changes often lead to commentary, and this change affects not only banks but all corporations. Every time tax rules change and banks are affected.... It happens on an ongoing basis. That's the way our system works.

It doesn't really affect OSFI's work. What we would focus on mainly is, if a bank does buy an operation in another country, what does that mean for our operations in terms of supervising it? Do we have to send a team to another country? Do we know that system well? Do we know the regulator well? Those are the things we focus on. Once an acquisition is made, we step into the picture.

**The Chair:** Thank you.

We'll continue now with Mr. Pacetti.

**Mr. Massimo Pacetti:** Thank you, Mr. Chairman.

Thank you, Ms. Dickson. It's nice to have you before the committee.

Here's a quick question on the Office of the Chief Actuary. It's part of the OSFI, but it operates independently, I understand. Are all the costs of the chief actuary recovered?

**Mrs. Julie Dickson:** Yes, most of his costs are in the form of user fees, so to speak, where he has memorandums of understanding with other government departments. When he works on Canada student loans, or CPP, or whatever, he is reimbursed by those departments for that work.

**Mr. Massimo Pacetti:** He won't do any work for your office?

**Mrs. Julie Dickson:** No.

**Mr. Massimo Pacetti:** So it just happens to be that he's under the OSFI, under your department. Does it just happen to be that way?

**Mrs. Julie Dickson:** Yes.

**Mr. Massimo Pacetti:** Another quick question is on the new anti-money laundering, anti-terrorism legislation. I think the office of the superintendent testified. Is there going to be additional work for your department to undertake in order to address any of the changes that were made in that bill?

**Mrs. Julie Dickson:** We've been doing a lot more work in the last four or five years. I don't think the bill would require us to increase it by a lot. What I'm more interested in is the international review that's currently being done in Canada by an international team. They're looking at what OSFI does in the anti-money laundering area.

I will be interested to see what that report says, because if the report is quite positive, it will be an indication that we're doing the right thing.

**Mr. Massimo Pacetti:** I'm viewing it more as the question, if it's going to require some additional work on your behalf, of how you recover costs for it.

**Mrs. Julie Dickson:** It would be billed to the financial institutions. We go in and look at banks and look at insurance companies and trust companies.

**Mr. Massimo Pacetti:** What about when it's some law enforcement agency that's asking you for some work; does that not happen?

**Mrs. Julie Dickson:** No, we have an agreement with FINTRAC, the financial analysis group. We do work on our own behalf, because it is part of something that—

• (1245)

**Mr. Massimo Pacetti:** No, but use the case of FINTRAC. If FINTRAC is asking you for whatever type of information they may be asking for, or even a law enforcement agency, will you not do any work for them?

**Mrs. Julie Dickson:** We don't have law enforcement agencies asking us to do work for them, but with FINTRAC we have an arrangement, wherever we thought it would be more efficient if we did the work as opposed to having us and FINTRAC going in and doing the same kinds of work.

**Mr. Massimo Pacetti:** But the cost is recovered from the financial....

Based on cost, there was talk that perhaps there was a lot of duplication of work with the Canada Deposit Insurance Corporation. I don't see any reference anywhere. I didn't bring the annual report with me, but has there been any talk about reducing the costs there, or about some reduction of duplication of work?

**Mrs. Julie Dickson:** In the last few years there were a lot of initiatives; there was a lot of effort put toward reducing overlap and duplication. Now only one agency approves new entrants into the sector. It used to be both of us; now it's only OSFI. Only one agency now sets out guidelines for sound business practice. That's OSFI now; it used to be both agencies. This has represented a tremendous decrease in duplication of activities.

Last year we pursued the work a bit further and looked at whether there were some back office costs that we could further reduce by partnering. That's still something that is on the table, but at this point I don't have anything new to report.

**Mr. Massimo Pacetti:** So, there's some ongoing—

[*Translation*]

**The Chair:** Thank you, sir.

Mr. St-Cyr.

**Mr. Thierry St-Cyr:** Thank you, Mr. Chair. I have a few questions. In fact, I have three, to be precise.

In the breakdown of the program by activities, under the heading "Regulation and supervision of federally regulated financial institutions", there is a figure in the column entitled "Capital" that amounts to almost \$7 million. For the following headings of "Regulation and supervision of federally regulated private pension plans", "International assistance" and "Office of the Chief Actuary", there are no capital expenditures.

What does this figure of \$7 million refer to exactly, and why is it categorized under the heading of regulation and supervision of federally regulated financial institutions?

[*English*]

**Mrs. Julie Dickson:** I'll answer the part on the oversight of financial institutions. Oversight would include the cost of teams that we send into financial institutions. They will go in, meet with senior management, ask for documents, ask to see board minutes and things like that.

[*Translation*]

**Mr. Thierry St-Cyr:** My question deals strictly with capital expenditures in relation to operations. There are two columns, one column entitled "Operating" and another column entitled "Capital". Under that column, nearly \$7 million have been allocated for one single activity, that of supervising financial institutions.

I wish to know what those expenditures were made on exactly, and why there are no capital expenditures for the other activities.

**Ms. Michèle Bridges:** I can answer your question. The reason why capital expenditures are found under that activity, is because it deals mainly with investments in financial systems, as Julie Dickson was talking about, such as the Basel II Accord implementation, as well as other changes made to accounting rules. When this budget was drawn up, almost a year ago, we still had not forecast all of the necessary capital costs in relation to private pension plans. Those costs can be found under the heading of operating costs, contained in the budget that was presented.

**Mr. Thierry St-Cyr:** Under operating costs?

**Ms. Michèle Bridges:** That's right.

**Mr. Thierry St-Cyr:** All right. Thank you.

I have another question I would like to ask. Earlier, we talked about a 6.5% increase. Pierre also mentioned this. You talked about inflation and merit. We can understand why costs have increased because of inflation, which is approximately 2%. But as for merit, how does this translate into increases? How much does that represent?

[English]

**Mrs. Julie Dickson:** I think that would refer to if you were at a certain level, the pay scale when you moved into the job would be  $x$  dollars, and over time the pay scale would rise, depending on the experience you'd gained.

• (1250)

[Translation]

**Mr. Thierry St-Cyr:** Therefore, it mostly covers fringe benefits, does it not?

[English]

**Mrs. Julie Dickson:** It's something you get only if you perform in the job.

[Translation]

**Mr. Thierry St-Cyr:** It's a matter of wages.

In closing, my last question deals with the requested appropriation of \$780,000. Once again, it is quite striking to note that in your expenditure budget, there's a balance for all activities, that is to say that revenue balances out with expenditures, except in the case of the Office of the Chief Actuary, where only one part of the expenditures has been recovered.

What explains this difference? Why must money be allocated to the chief actuary's office, and not for other activities?

**Ms. Michèle Bridges:** I will answer that question. The costs of activities other than that of the Office of the Chief Actuary are 100% recovered from the industry that we supervise and regulate. In the case of the Office of the Chief Actuary, it is the office which delivers certain services to certain pension plans or benefit plans within the federal government. Therefore, those services are covered by the appropriation we tabled.

**Mr. Thierry St-Cyr:** Therefore, that amount corresponds to the contribution made by the Office of the Chief Actuary in services provided to other organizations of the federal government?

**Ms. Michèle Bridges:** Exactly.

**Mr. Thierry St-Cyr:** All right. Thank you.

**The Chair:** And lastly, Ms. Wasylycia-Leis, you may ask a brief question to close.

**Ms. Judy Wasylycia-Leis:** Thank you. I have other questions.

[English]

I want to go back to pensions. In your 2005-06 annual report you state that one of the priorities going forward is to "contribute to financially sound federal government public pension and other programs through the provision of expert actuarial valuation and advice".

I'm asking you, given the fact that CPP contributors are not able to receive their benefits beyond 11 months, is there an actuarial reason that overrides this access to their rightful benefit?

**Mrs. Julie Dickson:** I think that's a question for the Office of the Chief Actuary. He is independent. He is the expert. He is situated within OSFI, which is why he's covered under our annual report.

**Ms. Judy Wasylycia-Leis:** Your office says that you are contributing financial advice to government on pensions in terms of actuarial evaluation and advice. Can you give us the same advice you're giving the government on this?

**Mrs. Julie Dickson:** No. That is advice that is given by the Chief Actuary of Canada.

**Ms. Judy Wasylycia-Leis:** Okay.

You've said that OSFI needs to—and I am quoting from your last annual report—"promote institutional behaviours that support good risk management". Given that, if you have a situation where banks are breaking the law or are appearing to break the law and they are embroiled in lawsuits, does it not make sense that this kind of behaviour affects the reputation of our banking institutions, that it could affect the whole issue of risk management, and therefore it requires some sort of oversight, investigation, and response on your part?

**Mrs. Julie Dickson:** Every year my assumption is that all types of institutions are going to be dealing with lawsuits. If we felt there were major problems with an institution that were leading to lawsuits all the time and that there did not seem to be any controls whatsoever, that is something we'd be interested in.

**Ms. Judy Wasylycia-Leis:** So if they break the law some of the time, it's okay, but if they break the law all of the time, it's not.

**Mrs. Julie Dickson:** I don't think you know whether they've broken the law until it's been through the courts.

**Ms. Judy Wasylycia-Leis:** Well, we have the FCAC report that documents violations. We just heard from them about 100-and-some violations by banks.

To reduce that inappropriate behaviour, do you take that information and say to the banks, if anyone should be upholding the law it should be you, our chartered banks?

**Mrs. Julie Dickson:** We have lots of conversation with banks, but it's always about things that, if not corrected, we think are going to lead to a safety and soundness problem. We would have to determine that. A lawsuit out there of that magnitude....

I would say that most of our discussions with the institutions are about their lending practices or whether they know how the portfolio is changing over time. Those are things that can lead to serious financial impact on an institution.

• (1255)

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

Thank you very much, Ms. Dickson. And thank you to your friends for being here today. We appreciate that as well.

Quickly, committee members, remember that on Thursday, from 11 until 12:30, we'll be hearing from the Canadian International Trade Tribunal and representatives from FINTRAC. Be prepared for that discussion.

We are adjourned.





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