Canada Deposit Insurance Corporation
Société d'assurance-dépôts du Canada

CDIC

ANNUAL REPORT • 1996/1997

Canada

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Canada Deposit Insurance Corporation
Société d'assurance-dépôts du Canada

Grant L. Reuber

Chairperson of the Board
Président du conseil d'administration

June 30, 1997

The Honourable Paul Martin, P.C., M.P.
Minister of Finance
140 O'Connor Street
L'Esplanade Laurier
East Tower, 21st Floor
Ottawa, Ontario
K1A 0G5

Dear Minister:

I have the honour to submit to you and the Secretary of State (International Financial Institutions) the Annual Report of the Canada Deposit Insurance Corporation for the year ended March 31, 1997.

Yours sincerely,

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17th Floor
P.O. Box 2340, Station D
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Priorities

Eliminate deficit and CRF borrowing

Strengthen capacity for risk assessment and maximize net recoveries

Reduce risk of losses

Develop by-laws

Improve productivity and cost effectiveness

Maintain fair and effective human resource and salary policies

Improve accounting, information and reporting systems

Propose and assess public policies

Maintain close liaison with government, regulators, and industry

GENERAL OBSERVATIONS

The Canada Deposit Insurance Corporation had a busy and successful year in 1996/97. Substantial progress continued to be made in advancing each of the nine priorities reviewed in last year's *Annual Report* and listed on the opposite page.

Particularly noteworthy was the success achieved in the following areas:

- The number of member institutions on CDIC's acute watch list decreased to a very small number, now accounting for less than one percent of all insured deposits, the lowest level in recent history.
- CDIC's borrowing was reduced to $865 million, which is consistent with its target of eliminating its borrowing by March 31, 1999.
- CDIC's accumulated deficit was reduced to under $1.2 billion and is forecast to be virtually eliminated by March 31, 1999.
- CDIC's accounting methodology to calculate the provision for insurance losses (formerly the general provision for loss) was revised to reflect more accurately its insurance risk—a change in accounting estimate that resulted in CDIC's provision for insurance losses increasing to $500 million.
- The winding-up of one member institution and the payment of the associated deposit insurance claims were effectively managed.
- Especially important was the successful completion of the sale of certain assets of North American Trust Company and its affiliated company, NAL Mortgage Company, to Brazos Fund L.P. The transaction concluded with the purchase by the Laurentian Bank of Canada of the remaining assets of North American Trust Company and NAL Mortgage Company. This was a large and complicated transaction completed within the budget provided for this purpose.
- Further progress was made in improving the yield, after expenses, of CDIC's claims and recoveries from the estates of failed institutions.
- To comply with the change in government policy vis-à-vis CDIC borrowing, CDIC completed a debt policy and a risk management policy and is well advanced in implementing a treasury program.
- A deposit insurance information by-law was enacted after extensive consultation with members and will come fully into effect in 1998.
- Substantial progress was made in developing a new by-law providing for differential deposit insurance premiums. CDIC hopes to enact the by-law in the coming fiscal year and apply it to premium assessments in April 1998.
- The suggestions emanating from the Auditor General's special examination in 1994 have mostly been dealt with, and those few remaining are being actively addressed.
- CDIC's continuing efforts over recent years to improve and maintain good employee relations were shown to have had considerable success in a recent employee survey.
- The Board of Directors reviewed CDIC's objects and their attainment and evaluated the Board's governance arrangements and possible improvements.

CDIC's projections indicate that its borrowing will be eliminated by March 1999.

Most of these developments are reviewed in more detail later in the report. Here the focus is on four topics:

- operating results and accounting changes
- deposit insurance information
- CDIC's objects and their attainment
- corporate governance

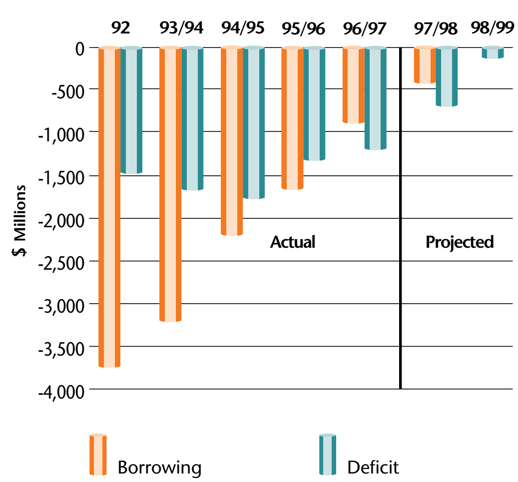
Operating Results and Accounting Changes

On March 31, 1997, CDIC's accumulated deficit was $1.2 billion and its loans from the Consolidated Revenue Fund totalled $865 million.

Although the deficit was $125 million below its level of a year earlier, it is important to recognize that this reduction occurred in the face of a change in accounting estimate, discussed below, that increased the provision for insurance losses by $350 million. Without this and other changes, CDIC's accumulated deficit would have been about $725 million, approximately 44 percent less than a year earlier. CDIC's total borrowing was reduced by almost one half.

Budgetary projections are necessarily based on a variety of assumptions that, as events unfold, may not prove valid. Among these are assumptions about the terms on which insurance is provided, about CDIC's responsibilities, about the circumstances of its members, and about continued progress in advancing CDIC's priorities. Nevertheless, based on what are believed to be relatively conservative assumptions, the projections depicted in Figure 1 indicate that CDIC's deficit (incorporating the recent change in accounting estimate) will be virtually eliminated and its borrowing fully eliminated by March 1999. Even under an adverse scenario and assuming premium rates remain at current levels, borrowing would be eliminated by March 1999 and the deficit by March 2000.

FIGURE 1:
Deficit and Borrowing Profile*



** Assumes no change in the current level of premiums.*

FIGURE 2:
Sources of Funds

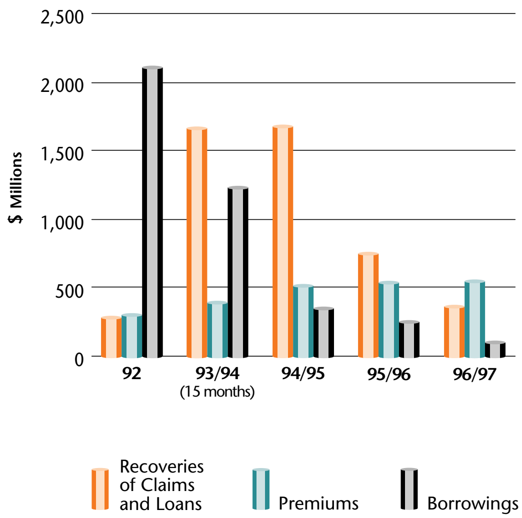
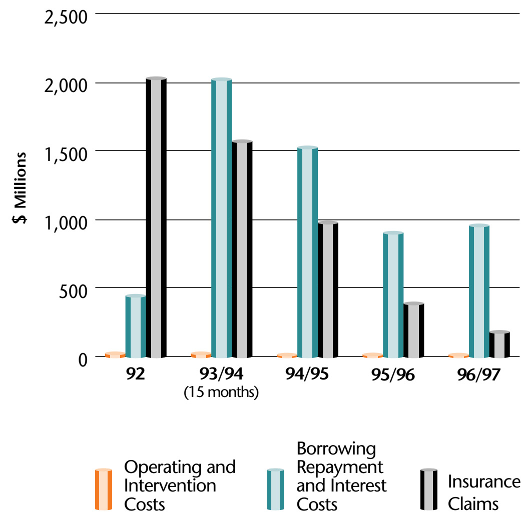


FIGURE 3:
Uses of Funds



Figures 2 and 3 indicate CDIC's major sources and uses of funds since 1992. Receipts from claims and loans receivable have decreased since 1994 as the volume of claims outstanding has diminished. Premium income has continued to grow, though at a much reduced rate.

It is unclear exactly why the growth of insured deposits has lagged behind the growth of uninsured deposits. Several factors appear to have contributed to this development. One is a sharp reduction in interest rates combined with increased price competition from uninsured deposits and money market funds relative to CDIC-insured deposits. At present, insured deposits are at a cost disadvantage of 17 basis points—the premium rate for insurance. Another factor is the consolidation that has occurred among firms and the consolidation of subsidiaries, such as mortgage companies, into the parent bank or trust company. Both inter-firm and intra-firm consolidations have resulted in the amalgamation of accounts held in the consolidating entities. Still another factor appears to be the increased securitization of the balance sheets of larger deposit-taking institutions, thereby reducing the pressure to raise relatively low-cost deposit funds to finance their balance sheet growth.

CDIC's net borrowing from the Consolidated Revenue Fund makes up the difference between cash receipts and disbursements. As already indicated, such borrowing at March 31 had decreased by almost half during 1996/97.

The growth of insured deposits has lagged behind the growth of uninsured deposits.

Operating and capital expenses have remained unchanged for the past four years.

Operating and capital expenses have remained unchanged for the past four years at approximately $14.5 million. In 1996/97 these costs accounted for one percent of total outlays. Interest costs fell by $37 million, reflecting less borrowing and lower interest rates. (The average rate on CDIC borrowings in 1996/97 was 6.5 percent.)

The number of employees (full-time equivalent) at the end of March 1997 totalled 87, down from 99 a year earlier, and the total number of permanent employees totalled 77, 9 less than a year earlier.

CDIC records the following allowance and provisions for loss in its financial statements:

a) allowance for loss on loans and claims receivable: CDIC's best estimate each year of likely future losses from claims against insolvent members arising from payments made to insured depositors and loans made to member institutions and others under loan agreements.

b) provision for guarantees: CDIC's best estimate each year of the amounts likely to be required in future to meet guarantees to support certain transactions undertaken to deal with members in financial difficulty.

c) provision for insurance losses: CDIC's provision against future losses likely to occur on insured deposits of members that remain in business.

In the past, the provision for insurance losses was based on CDIC specific knowledge and its historical loss experience. This methodology resulted in virtually all of the provision for potential losses relating to members on the watch list. Only a negligible provision was provided for potential losses related to members ***not*** on the watch list.

To address this gap, the Board decided to expand the provision for insurance losses to include an explicit estimate of the potential losses associated with members not on the watch list. The methodology used to estimate this part of the provision for insurance losses is based upon a composite market rating of CDIC members and the risk premiums charged by the market for differently rated companies. On this basis, the provision reflects the market's implicit estimate of the risk associated with members not on CDIC's watch list. (Further details are provided in the Financial Overview section of this report.) As a result of this change in accounting estimate, CDIC's provision for insurance losses was increased by $350 million, to $500 million.

With this change, CDIC has provided for all its potential losses arising from discernible risks. It will not, however, build up capital in the form of a surplus to provide a further cushion for unexpected losses—i.e., uncertainty—as might be done by a private corporation. The rationale for not providing a surplus to cover uncertainty is that CDIC has highly assured access to funding should the unexpected occur. These sources are the statutory obligation of members to pay premiums (within specified limits), CDIC's access to private markets with its agent ability to use the federal Crown's credit (for which CDIC pays a fee), and its access, as a last resort, to loans from the Consolidated Revenue Fund.

The current provision for insurance losses of $500 million is approximately one-sixth of one percent of the total deposits insured by CDIC. Should the unexpected happen, CDIC would have access to over a billion dollars, after raising premium rates to their maximum, to deal with problems without additional net borrowing. This is approximately twice as large as the largest annual deficit experienced by CDIC throughout its 30-year history.

In making this change in accounting estimate, the Board also adopted two further policies:

- that CDIC design its differential premium by-law and recommend premium rates to the Governor in Council so that its operating costs and provisions will be covered without also building up a surplus;
- that, beginning with the fiscal year 1996/97, the financial statements no longer show figures for the Deposit Insurance Fund or a figure for Accumulated Net Earnings.

An important consequence of these changes is that after the year 2000, barring the unexpected and following the policy it has adopted, CDIC will be able to recommend to the Governor in Council that premium rates for deposit insurance be greatly reduced. This reduction in the cost of deposit insurance will materially reduce the cost of deposit insurance to members. At the same time, it will reduce the cost disadvantage now borne by CDIC-insured deposits relative to uninsured deposits and money market funds.

Another important consequence is that differential premiums will become much more significant as the spread widens between the premium paid by the higher-rated category of members and that paid by the lower-rated category of members. At present, all members pay a premium of one-sixth of one percent of insured deposits. When differential premiums are introduced, the lower-rated category of members can expect to pay one-third of one percent—the maximum permitted by law. At the same time, when the deficit has been eliminated, the premium rates for the higher-rated category can be expected to fall substantially.

In short, current projections and the policies now in place hold out the welcome prospect that by March 31, 2000, CDIC will have eliminated its deficit and its borrowing, will have provided for potential losses arising from the risks it insures, will have more than a billion dollars available to deal with unexpected problems after allowing time to raise premium rates to their maximum, will have reduced premium rates considerably for its higher-rated members and will have increased the incentive effects of differential premiums applicable to lower-rated members. If this prospect is realized, as seems likely, issues related to deposit insurance might be expected to generate less public controversy in the future than they have in the past.

By the turn of the century, CDIC expects to have eliminated its deficit and its borrowing, and premium rates can be expected to fall substantially.

A new system is being established to provide more information and more reliable information to consumers in a more convenient way.

Deposit Insurance Information

Since 1987, in the wake of the failure of Principal Trust, when depositors complained that they had been given incorrect information, employees of deposit-taking institutions have been prohibited from providing information about deposit insurance at the place of sale (frequently referred to as the "gag rule"). When customers inquire about deposit insurance, employees are required to direct the inquiry to CDIC and provide the appropriate toll-free telephone number and mailing address. Moreover, a formal system to confirm the eligibility for insurance of deposit products sold by members prior to, or even subsequent to, sale in the marketplace was never developed. As a consequence, as new and more complex products are sold, there is considerable uncertainty on the part of the buyers, and sometimes the sellers, as to whether any specific product is eligible for deposit insurance. In addition, with the emergence of many new products that are close substitutes for deposits, the possibility for consumers to be misled, inadvertently or deliberately, as well as confused about the applicability of deposit insurance has increased over the years. The main safeguard has been the requirement for member institutions to stamp non-Canadian-dollar deposits and other uninsured deposits as "uninsured."

In order to make more information and more reliable information available to consumers in a more convenient way, work on a new deposit insurance information by-law began four years ago. This entailed extensive consultation with the providers of deposits and similar financial products. This work culminated in the Deposit Insurance Information By-law, which was enacted on December 4, 1996. After allowing some time for the necessary preparatory work to be completed, the by-law will come fully into force on March 1, 1998.

Three basic requirements were stressed in developing the by-law: truth and accuracy of the information available, easy accessibility to consumers, and financial feasibility and cost-effectiveness. These requirements were expressed in five key principles agreed upon during consultation as a guide to the process:

i) An informed public serves the interests of consumers and the financial system as a whole.

ii) Consumers bear responsibility to become reasonably informed about deposit insurance and to make their own decisions.

iii) The effectiveness of delivery and the affordability of information on deposit insurance are primary considerations.

iv) Pertinent and accurate information on deposit insurance and on whether or not particular deposit products are covered by insurance should be readily available to consumers at the place of sale.

v) Practices and procedures for providing information should be straightforward, cost-effective and open to continuing review.

The main features of the new by-law may be summarized as follows:

- It is an offence for anyone (not just a member institution as before) to provide false or deceptive information about what constitutes a deposit or an insured deposit or about who is a member of CDIC. This provision applies to deposit brokers, investment dealers, insurance agents, mutual fund salespeople, the general public, and employees of member institutions.
- Regulations related to advertising a company's membership in CDIC and to CDIC membership signs and their use in premises shared with non-members have been updated, clarified and made more stringent.
- Each member is required to prepare and maintain an up-to-date register of deposit products approved for CDIC insurance, wherever and however products are sold. Each member is also required to display the register prominently in each of its places of business and to have readily available for customers a copy of both the register and CDIC's information brochure either in one combined document or in separate documents.
- All deposit-like products available from members have to be cleared with CDIC before being listed on their register of deposit products. In order to deal with the inventory of products now being sold, existing products will be reviewed and cleared between now and March 1, 1998, when the by-law becomes fully effective. As for new products, guidelines and procedures have been established to afford flexibility and minimum turnaround time for pre-clearance.
- Employees of member institutions are permitted to discuss any of the information contained in the register or in CDIC's brochure. The "gag rule" has been removed.
- Negative stamping—i.e., a printed message that a product is not eligible for CDIC insurance—will continue as in the past for instruments, sold by members, that are not eligible for insurance. Such messages may now be provided electronically or by telephone.
- No explicit provision is made in the by-law for deposit brokers and others selling deposit products as agents. The onus is on member institutions to ensure that accurate, adequate and accessible information is available to the buyers of their products wherever and however they are sold.
- Although CDIC will provide assistance in the form of guidelines and information, responsibility rests with members to train their employees so that they can provide accurate information to customers about deposit insurance. The transition period to March 1, 1998, provides time for such training to be completed.
- Self-compliance and monitoring of procedures are incorporated into the Return of Insured Deposits form submitted by members each year—the form that also provides the basis on which insurance premiums are calculated for each institution.

The "gag rule" has been removed.

These changes, when fully implemented, will result in a major improvement in the availability, accuracy, and adequacy of deposit insurance information provided to consumers. Provision has been made to accommodate some modifications in the

CDIC's objects are spelled out in the CDIC Act.

detailed application of the by-law to permit fine-tuning adjustments that may be helpful as the system is put into place. In order to facilitate the smooth implementation of the by-law and to monitor and adjust the system after March 1998, an industry consultative committee has been struck. Its members include representatives of the Canadian Bankers Association, three banks, two trust companies, and CDIC.

The completion of this task has been greatly helped by all those who have directly participated in the consultative process. This includes the members of CDIC's Advisory Committee on Consumer Information as well as the Deposit Insurance Information By-law Industry Consultative Committee, organized jointly by CDIC and the Canadian Bankers Association.

CDIC's Objects and Their Attainment

In order to measure performance it is necessary to have a definition of the objectives sought and a measure of how well the objectives are being achieved. CDIC's objects are spelled out in the CDIC Act. During 1996, the Board elaborated and clarified CDIC's statutory objects and how the attainment of these objects is assessed.

The CDIC Act sets out three objects, each of which will be considered in turn.

a) ***to provide insurance against the loss of part or all of deposits:*** This is an unqualified, clearly defined and easily measured object that CDIC has met fully throughout its history. As such, it is unambiguous. The means whereby this is accomplished are many and varied, given the breadth of CDIC's express and implicit powers.

The amount of insurance provided, the basic terms on which it is provided, the definition of deposits eligible for insurance and the financial resources available to CDIC to meet this object are spelled out in government legislation and regulations. As such, these aspects of deposit insurance are not within CDIC's discretion.

b.1) ***to promote standards of sound business and financial practices:*** CDIC has issued an explicit set of standards that have now been implemented among deposit-taking institutions. They are being emulated in the life insurance industry, among some credit unions, and in the property and casualty insurance industry. The standards are continually reviewed to keep them up-to-date and to find ways of improving them.

There is no quantitative measure of how effectively CDIC is discharging its mandate in this area. Judgement and discretion on this criterion within CDIC remain with the Board of Directors. Judged by international practice and the extent to which they are being emulated by the insurance industry and credit unions, CDIC's standards today are considered by the Board and management as among the best in the world.

b.2) ***to promote and otherwise contribute to the stability of the Canadian financial system:*** This object reflects the primary reason for having deposit insurance: to prevent runs on deposit-taking institutions and thus avoid the destabilizing spillovers on the system as a whole arising from the failure of one or more deposit-taking institutions. This rationale for deposit insurance was spelled out at greater length in the CDIC 1994-1995 *Annual Report*, Appendix I.

It is important to note that this object refers to the stability of the financial system and not to the viability of individual financial institutions. The latter is not part of CDIC's mandate.

How vulnerable the stability of the financial system is to the failure of an individual financial institution depends on a number of considerations. These include, among others, the soundness, financial strength, liquidity and profitability of the system, the size of the failing institution, the level of insured deposits among weaker institutions, the general state of the economy, and government regulatory and financial policies. Over the years, the ability of the system to sustain individual failures of deposit-taking institutions without destabilizing consequences has evidently been quite robust and possibly has grown even more so in recent years.

It is a central premise of deposit insurance that the demonstrated stability of the financial system in the face of the failure of individual deposit-taking firms owes much to the guarantee afforded deposits by the insurance provided. The key test of whether CDIC has met the stability object is whether, as a consequence of an individual failure, significantly large runs have developed on deposits in other institutions to impair the stability of the system.

In addition to guaranteeing insured deposits, CDIC further contributes to the stability of Canada's financial system by operating an effective and efficient system of deposit insurance that provides timely payments to depositors of a failed member institution up to the insured limits. The timeliness and accuracy of such payments also help to avoid runs on deposit-taking institutions and generally contribute to the stability of the system.

There is no evidence that CDIC has ever failed to meet this stability objective since it was established in 1967. Its insurance liability has been consistently and fully met. And its payment of deposit insurance claims to insured depositors has been made promptly and efficiently. During the last four years, the average time for such a payment has decreased by 60 percent—from 10 weeks to 4 weeks—and the net cost per deposit account by 98 percent—from $104 to $2. Effective machinery is in place to handle communications, emergency situations and disputes when failures occur.

Success in the past is no guarantee, of course, of success in the future. This issue is addressed by the Board of Directors every time an intervention is contemplated. It is also a consideration in reviewing the risk status of an institution and the likelihood that one form or another of intervention may be required. Inevitably, judgement and discretion within CDIC ultimately rest with the Board, acting within the parameters set out by the Government in legislation and regulations as noted earlier.

CDIC's mandate focusses on the stability of the financial system and not on the viability of individual financial institutions.

CDIC deals with failed institutions through a process based on market tests designed to minimize the cost of failures.

c.1) ***to pursue objects (a) and (b) for the benefit of persons having deposits with member institutions:*** The benefit to those with insured deposits is having the nominal value of their insured deposits fully covered. This object is fully met when the value of their deposits is restored to them. Under its mandate, CDIC has no obligation to uninsured depositors, to other creditors, or to shareholders.

c.2) ***to pursue objects (a) and (b) in such a manner as minimizes the exposure of the Corporation to loss:*** Pursuit of this object has two aspects: minimizing failures and dealing with failures when they occur in the least expensive way.

Establishing standards on deposit-taking institutions, working with the Superintendent of Financial Institutions and provincial regulators to reduce the possibility of failures, intervening earlier into the affairs of problem member institutions, and introducing differential premiums are all being done in an effort to reduce the number of failures. There is no satisfactory statistical measure against which achievement of this aspect of CDIC's mandate can be judged. The matter is ultimately the responsibility of CDIC's Board of Directors, subject to the parameters provided by the legislation governing CDIC.

The second aspect of this object concerns minimizing the cost to the Corporation of member failures when they occur. To this end, CDIC simultaneously evaluates the cost and risk of at least two optional ways of dealing with a failure and then chooses the least expensive option unless the objects dictate a different choice. Frequently, this leads to comparing the costs of liquidating an institution with the costs of selling it in whole or in parts in a competitive bidding process. In short, as far as possible, CDIC deals with failed institutions through a process based on market tests designed to minimize the cost of failures to CDIC. This process is reinforced by having the Real Estate Advisory Panel, made up of 10 business people actively engaged in real estate markets, provide advice on the valuation of assets in all transactions of significant size.

Finally, it is important to note what is ***not*** included in CDIC's mandate. CDIC is a statutory corporation, an "agent of the Crown." Therefore, the *ultra vires* doctrine applies, which means that CDIC has only the powers provided to it in its legislation and cannot go beyond them.

It is important to understand that CDIC does not have a mandate to recognize costs to the economy in relation to employees and employment, to uninsured depositors and other creditors, to shareholders, to regional concerns, and to many other factors influencing the economy and the community frequently raised in public discussions. Its mandate focusses solely on insured depositors, the stability of the financial system, and the costs of providing insurance.

This said, many of these interests benefit indirectly from CDIC's activities in several ways, including (i) its promotion of standards of sound business and financial practices, (ii) its promotion and contribution to the stability of the financial system, (iii) its promotion of the promulgation of consumer information and financial information, in collaboration with the Office of the Superintendent of Financial Institutions, and (iv) its obligation to minimize the exposure of the Corporation to loss, which usually also minimizes the losses for others.

Corporate Governance

In response to the increased general concern about the effectiveness in the governance of both private and public corporations, in mid-1996 the Board of Directors undertook a careful review of the governance of CDIC. The Board based its review on the Canadian Comprehensive Auditing Foundation's (CCAF) governance framework and was assisted by Mr. John Palmer, Chairman of the Foundation's Governance Advisory Panel and also Superintendent of Financial Institutions and a director of CDIC, and by Messrs. J. P. Boisclair and David Moynagh of the Foundation. (The Auditor General of Canada, the auditor of CDIC, is also a member of the Foundation's Governance Panel.) The actual review was carried out by a task force made up of Mr. Colin P. MacDonald, a director of CDIC, and Mr. Lewis T. Lederman, CDIC's Corporate Secretary and General Counsel.

Following a briefing from CCAF, the task force met individually with each CDIC director, all but one alternate director, the Minister responsible for CDIC, and CDIC's President and Chief Executive Officer. The task force also reviewed relevant, current literature on corporate governance, including a late draft (since published virtually unchanged) of the joint Department of Finance/Treasury Board report entitled *Corporate Governance in Crown Corporations and other Public Enterprises*.

The six questions developed by CCAF that provided the basic framework for the review of CDIC's governance are as follows:

1. Do directors have the necessary knowledge, ability and commitment to fulfil their responsibilities?
2. Do directors understand their purpose and whose interest they represent?
3. Do directors understand the objectives and strategies of the organization they govern?
4. Do directors understand what constitutes reasonable information for good governance and do they obtain it?
5. Once informed, are directors prepared to act to ensure that the organization's objectives are met and that performance is satisfactory?
6. Do directors fulfil their own accountability obligations to those whose interests they represent by reporting on the organization's effectiveness?

The Board of Directors undertook a careful review of the governance of CDIC.

The directors of a Crown corporation are placed in charge of what is essentially a private law vehicle (i.e., the Corporation) to carry out a mandate given by Parliament to serve a specific public interest. Although the CDIC Board shares the same fiduciary responsibilities with private boards of directors, its composition and functions are fundamentally different and unique. For one thing, CDIC's objects (as described earlier), constitution, powers, and duties, the terms of deposit insurance, and its general method of operating are spelled out by statute; they are not subject to the discretion of the Board or directly influenced by market forces. For another, all directors are appointed by the Government, *The combination of the two types of directors is not only unique but also the great strength of CDIC's Board.*

not by the Board itself, nor are any nominated by the Board. Moreover, out of a total of nine members, five (including the Chairperson) are *ex officio* Government-appointed officials, four of them with senior responsibilities in departments or agencies other than CDIC.

As a Crown corporation under the *Financial Administration Act*, CDIC is "ultimately accountable, through the appropriate Minister, to Parliament for the conduct of its affairs." Under the CDIC Act, the Board's responsibility is to attain the objects described earlier in this report—no more and no less. This tight definition of CDIC's objects closely circumscribes the discretionary powers of the Board. Should an irreconcilable disagreement arise between the Government and CDIC, the Government may, after consultation, give a directive to CDIC on the grounds that "it is in the public interest to do so." CDIC is obliged to follow such a directive if it falls within its mandate, and the Government is obliged to table it in Parliament. During its history, CDIC has never received such a directive.

Ex officio directors tend to reflect a public policy perspective and a knowledge of government and of what is feasible within the constraints of the government policies. In addition, the Chairperson of CDIC along with three senior *ex officio* members on the Board are statutory members of the Financial Institutions Supervisory Committee and members of the Department of Finance's Senior Advisory Committee. Although these committees are not decision-making bodies, they examine many of the issues affecting CDIC, consider options, and recommend actions subject to the appropriate approvals being obtained. This gives the five *ex officio* members of the Board a somewhat different perspective than the private members when issues are discussed and decisions are made by the Board.

Private-sector directors bring to the Board private-sector expertise and experience, a market sense, and a non-governmental focus on their responsibilities and obligations and on what is feasible and desirable from the standpoint of the marketplace. All are fully independent of any deposit-taking company. They are not there as consultants or advisers. They are full partners in the decision-making process and participate actively and directly in it on the same basis as the government officials on the Board.

The combination of the two types of directors in one Board is not only unique but also the great strength of the Board. Private and public talent, expertise, perspectives and judgement are brought to bear within a defined corporate framework to make decisions dealing with failing deposit-taking institutions and providing an effective system of deposit insurance at minimum cost to the public as specified in the CDIC Act.

The task force report found that all the directors share the view that, for the most part, the Corporation's present governance practices are sound and that the Board works well and effectively with the information provided by management and in accordance with the objects set forth in the Corporation's governing legislation. This was reflected in the generally positive answers to all six CCAF questions. At the same time, the task force made a number of recommendations, including the following:

- developing detailed director profiles (skill-set specifications) for the private-sector directors appointed by the Governor in Council to assist the Minister of Finance in evaluating potential director candidates;
- developing more specific descriptions of the responsibilities of Board members, the Chairperson, and the President and Chief Executive Officer than are now available;
- setting aside a significant portion of one Board meeting once a year for discussion of corporate governance issues, including specifically a review of the obligations of both private and *ex officio* directors;
- reviewing annually CDIC's corporate governance against the checklist provided in the Department of Finance/Treasury Board report;
- providing earlier Board input into the development of the *Corporate Plan* and also continuing the efforts made in the past to educate directors on developing issues;
- improving a number of areas with respect to providing information to directors, particularly follow-up information;
- including a section on corporate governance practices in the *Annual Report*.

The task force also recommended against the creation of a Board committee on corporate governance. Instead, it proposed that a review be conducted every two or three years similar to the one conducted by the task force.

The Board unanimously adopted all the recommendations of the task force, and all are being implemented. Accordingly, a new section has been added to the *Annual Report* entitled Corporate Governance. This section includes a tabulation comparing CDIC's practices with the guidelines provided in the Department of Finance/Treasury Board report. The table shows that CDIC has dealt with or is addressing the governance factors identified in this report.

As an organization, CDIC greatly appreciates the excellent work done by the members of the task force—Messrs. MacDonald and Lederman—in conducting this review of CDIC's corporate governance. It is also grateful to all the directors, alternates, and the Minister responsible for CDIC for participating fully in the review and to the members of CCAF for their helpful advice in conducting the review.

The task force report found that the Corporation's present governance practices are sound.

CDIC received the Auditor General of Canada's Award for Excellence in Annual Reporting by Crown corporations.

In March 1997, CDIC received the Auditor General of Canada's Award for Excellence in Annual Reporting by Crown corporations, in its category, after having been a finalist the year before. The annual award represents "the best in accountability reporting through annual reports and corporate plan summaries" and is judged on the basis of the following four main factors: excellence in reporting both financial and operational performance; provision of relevant, clear and meaningful objectives that can serve as indicators for measuring and reporting; emphasis on the corporate environment and the risks inherent in operations; and discussion of future direction and plans.

The effectiveness and efficiency of CDIC continues to depend very heavily upon the performance of its management and staff. As in the past, on March 12, 1997, the Board expressed its appreciation to the management and staff for their excellent and conscientious work during the year. It also greatly appreciates the contributions that the various committees listed in the Corporate Governance section of this report continue to make to CDIC's activities.

In August, Mr. Marcel Caron retired from the Board of Directors after serving over eight years. During his period in office, Mr. Caron contributed greatly to the development of CDIC, both as a member of the Board and as Chairman of the Audit Committee. On August 7, the Board welcomed Mr. Viateur Bergeron, a distinguished lawyer and law professor. And earlier, on July 23, following an amendment of the *Office of the Superintendent of Financial Institutions Act*, the Board welcomed Mr. John Thompson, the Deputy Superintendent, Operations, OSFI, as an *ex officio* member.

During the fiscal year 1996/97, the Board met seven times. One meeting was held in Montreal, one was held in Toronto, and the rest were held in Ottawa or were specially convened meetings conducted by telephone. In addition to its normal business agenda, the Board met with provincial regulators from Quebec and Ontario and with the Auditor General of Canada. The Board also met informally with The Honourable Doug Peters, the Secretary of State (International Financial Institutions), representatives of the Canadian Bankers Association, Mr. J. Baillie, Chairman of the Task Force on the Future of the Canadian Financial Services Sector, Mr. J. Peterson, Chairman of the House of Commons Standing Committee on Finance, and Ms. Ricki Helfer, Chair of the Federal Deposit Insurance Corporation in the United States.

Grant L. Reuber
Chairperson of the Board

Jean Pierre Sabourin
President and Chief Executive Officer

INSURANCE AND RISK ASSESSMENT

CDIC's Membership in 1996/97

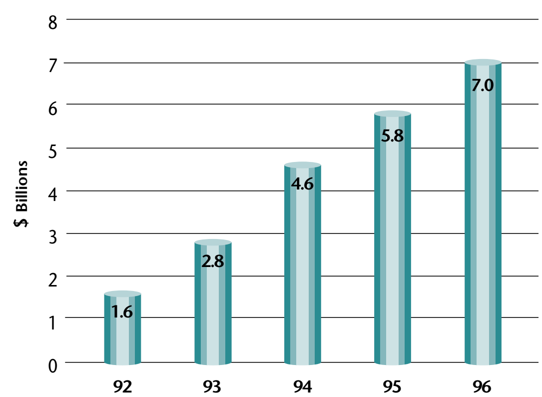
The past year was a good year for the financial industry in Canada. For the first time ever, the total profit of CDIC members approached the $7 billion mark. Approximately three quarters of all CDIC members reported a higher profit in 1996 than they did the previous year, and only six percent reported a loss. The return on average assets improved for the fifth consecutive year and exceeded the 0.4 percent mark for all peer groups.

This year's strong results mainly reflect solid asset growth and an improvement in asset quality. Assets have been growing at a healthy average annual rate of 10 percent since 1992. As a result, for the first time ever, the total assets of CDIC's membership have exceeded the $1 trillion mark.

Total assets for banks (domestic and foreign) and their subsidiaries have grown the fastest since 1992, at slightly more than 10 percent. This has resulted in a steady increase in this group's share of total assets. By contrast, total assets of those institutions classified at March 31, 1997, in the trust and loan companies peer group have, on average, grown by less than 3 percent since 1992, and their market share has dropped accordingly. Mergers, acquisitions, failures, and fierce competition in the lending business have been the principal causes of the relatively lower asset growth for the trust and loan classified members.

The overall asset quality of CDIC's members continued to improve in 1996 as a result of a more favourable economic environment.

FIGURE 4:
Net Income of CDIC Members

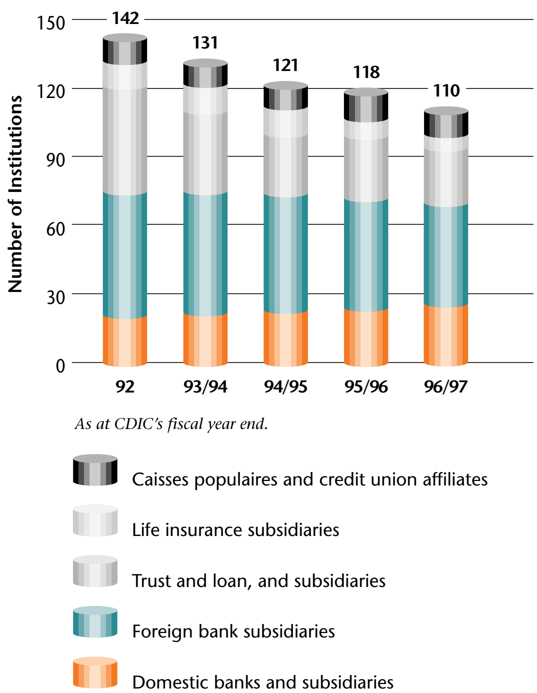


Ratios of impaired loans to total assets, to total loans, and to total shareholders' equity have, for all peer groups, dropped significantly over the last few years. Furthermore, the percentage of impaired loans that are unprovided for has decreased substantially since 1992, from an average for all member institutions of 55 percent to 26 percent for fiscal 1996.

Net interest spreads have increased slightly this year, reflecting mainly the decrease in provisions for loan losses from $3.0 billion to $2.3 billion last year. Income from non-interest sources for all CDIC member institutions reached $14 billion in 1996, representing on average 40 percent of net income before non-interest expenses and taxes.

The total assets of CDIC's membership have exceeded the $1 trillion mark.

FIGURE 5:
Member Institutions



As at CDIC's fiscal year end.

Member institutions maintained a tight control on their expenses despite the strong growth experienced in the last few years. The average percentage of non-interest expenses over assets has decreased since 1992, from 3.7 percent to 3.0 percent.

The number of CDIC member institutions at March 31, 1997, dropped to 110 from 118 at the same time last year. Amalgamations of financial institutions resulted in some consolidation in CDIC's membership. CDIC also cancelled the deposit insurance policy of six member institutions. In all these cases, all or part of the assets were purchased and all the deposit liabilities were assumed by other financial institutions.

CDIC added four new institutions to its list of members (Swiss Bank Corporation Trust, ING Trust Company of Canada, First Nations Bank of Canada and Citizens Trust Company) and terminated the deposit insurance policy of one member institution, Security Home Mortgage Corporation.

Failures in the 1990s

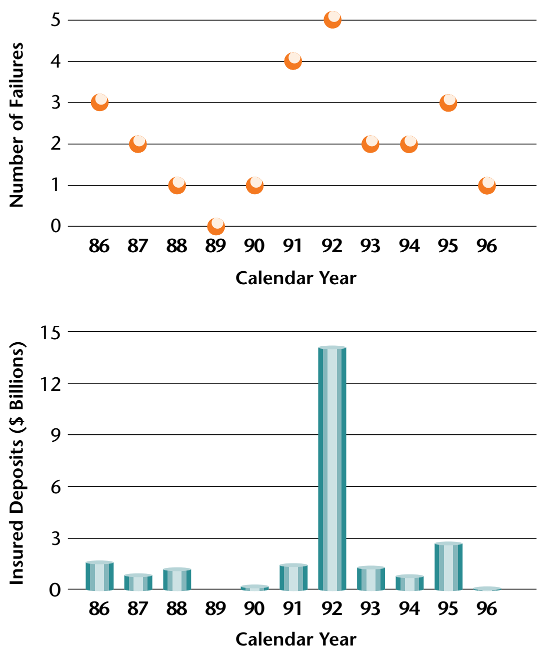
For financial institutions in Canada, the 1990s have been years of great change. For most CDIC members, the challenges of the 1990s have turned into attractive opportunities; for others, they were obstacles that could not be surmounted.

As was the case in the 1980s, banking problems in the 1990s have essentially been an outcome of poor management and inadequate controls and procedures. Recent studies from the Bank of England and the U.S. Office of the Comptroller of the Currency, supported by an abundant literature on bank failures, identified poor management as the most important factor leading to institutional failures in those countries.

In Canada, more than three quarters of the 24 bank, trust, and loan company failures from 1986 to 1996 were caused by mismanagement. The lack of business plans and any coherent strategy for dealing with the risks facing these institutions were generally the causes. Many of the other failures were a result of a parent's financial distress. In a few cases, fraud appeared to be at the heart of the failure. Other factors that contributed to failure include rapid growth, excessive loan concentration in certain segments of the real estate industry, poor controls, and violations of laws and regulations.

A common characteristic of many failed institutions was a lack of control systems. In particular, this included inadequate credit rating systems and review processes and an absence of documented policies and procedures related to concentration limits.

FIGURE 6:
Number of Failures and Total Insured Deposits in Failed Institutions



Mounting provisions for loan losses and write-offs required to reflect the depressed real estate values in the 1990s eroded the earnings of most financial institutions in Canada. Many of the failures, such as Central Guaranty Trust Company in 1992, and many of the problems experienced by other institutions were related to an excessive exposure to distressed segments of the real estate market.

Deregulation, technological advances, and globalization in the financial sector have increased the volatility and risks to which CDIC members are now exposed. Lessons of the past suggest that managers of financial institutions will have to continue to develop sound and prudent business plans and strategies, avoid over-concentration in any given sector, refrain from excessive risk-taking and aggressive market share expansion, and ensure the existence of strong controls and procedures in their institutions.

CAUSES OF FAILURES

Mismanagement
- lack of business plans and coherent strategies
- excessive risk-taking in expanding market segments

Control System
- inadequate control systems to ensure compliance with internal policies and supervisory rules
- inadequate credit analysis and loan review procedures

Poor Asset Quality
- excessive concentration in a single sector
- excessive loan growth in relation to management, control systems, and funding sources
- overlending (high loan-to-debt serviceability ratio)

Poor Liquidity
- lack of cash to ensure the continuation of operations: caused by mismatch of loans and short-term assets and liabilities

Capital Adequacy
- inadequate capital to meet all applicable regulatory requirements and/or operating losses

Fraud and Concealment
- material fraud generally includes the intent to deceive and/or an attempt to conceal
- insider abuse in self-dealing

Parent (or group contagion)
- difficulties caused by problems elsewhere in the group

The industry's favourable financial condition in 1996/97 resulted in fewer failures and problem institutions.

Failure Resolution Initiatives

The industry's favourable financial condition in 1996/97 resulted in fewer failures and problem institutions. At present, CDIC is closely monitoring 75 percent fewer member institutions than it did in 1993. The insured deposits of these higher-risk members represented less than one percent of the total insured deposits at April 30, 1996.

During the year, CDIC was required to make payment in respect of the insured deposits in only one member institution: Security Home Mortgage Corporation. CDIC also completed its facilitation of the sale of North American Trust Company and NAL Mortgage Company, both former CDIC member institutions.

Security Home Mortgage Corporation

Security Home Mortgage Corporation (SHMC) was a federally incorporated mortgage investment company with assets at the time of failure of approximately $50 million. SHMC's risk profile increased sharply throughout 1994 and 1995 as a result of increases in the level of non-performing loans, continued losses, and capital deficiency.

In the summer of 1995, CDIC undertook a special examination of SHMC's assets. The results of the examination indicated that additional provisions for loan losses were required. The increase in provisions identified by the special examination exacerbated the already overborrowed situation.

On October 30, 1995, CDIC delivered a report to SHMC, pursuant to section 30(1) of the CDIC Act, advising SHMC that, in CDIC's opinion, SHMC was not following the CDIC Capital Management Standard and that the company was in breach of its policy of deposit insurance. The company was instructed to rectify the breach of its policy and achieve compliance with the standard by December 31, 1995.

Throughout the end of 1995 and in early 1996, SHMC attempted, without success, to attract outside investment to recapitalize the company. On March 1, 1996, CDIC sought the approval of the Secretary of State (International Financial Institutions) to give SHMC not less than 30 days' notice of termination of its policy of deposit insurance. SHMC was officially notified on May 3, 1996, that its policy of deposit insurance would be terminated on June 4, 1996. On that date, SHMC's policy of deposit insurance was terminated, and shortly thereafter CDIC made deposit insurance payments (totalling $42 million) for all the insured deposit liabilities of SHMC.

On June 4, 1996, the Superintendent of Financial Institutions was directed by the Secretary of State to take control of SHMC. Furthermore, the Minister requested the Attorney General of Canada to apply for an order under the *Winding-up Act* to wind up SHMC. On June 10, 1996, the Attorney General applied for an order to wind up SHMC. This petition was denied on June 24, 1996. Following the subsequent appeal of this decision, an order was granted on November 22, 1996, for the winding-up of SHMC effective June 6, 1996. The provisional liquidator was appointed on December 5, 1996.

North American Trust Company and NAL Mortgage Company

During the course of the year, CDIC brought to a conclusion its facilitation of the transaction involving the sale by NAL Trustco Inc. of its deposit-taking subsidiaries, namely North American Trust Company and NAL Mortgage Company (jointly referred to as NAT). CDIC's involvement in the NAT file goes back to 1992 and the sale of NAT, formerly First City Trust Company and First City Mortgage Corporation, to North American Life Assurance Company (NAL).

Because of NAT's requirement for further capital and the continued poor performance of its asset portfolio, NAL announced in early 1995 its intention to sell NAL Trustco Inc. and its subsidiaries (including NAT). In September 1995, CDIC facilitated a transaction with Laurentian Bank of Canada (Laurentian) and Brazos Fund L.P. (Brazos) for the purchase of NAT and its related assets.

On October 1, 1995, Laurentian purchased all the shares of NAT, and CDIC compensated (net of the sale price of $70 million) Laurentian for the difference between the book value of the assets purchased and the deposit liabilities assumed. The transaction closed on the basis of estimated financial statements that were subject to audit.

The agreements respecting the purchase by Brazos of most of the substandard and non-performing assets of NAT included provisions whereby, within appropriate time after closing, Brazos could bring forward assets with defects in respect of title, legal, or environmental issues. CDIC would then either cure the defect, accept an adjustment to the sale price of the asset, or repurchase the asset from Brazos.

During 1996, CDIC actively negotiated settlements with Laurentian and Brazos. In July 1996, Brazos agreed to a final settlement of all post-closing adjustments, as did Laurentian in October 1996. CDIC's final net cost of facilitating the Brazos and Laurentian transactions, over and above the funds committed under the 1992 facilitation agreement with NAL, amounted to $125 million.

Risk Management and Assessment Initiatives

Since there was only one failure in 1996/97, CDIC was able to allocate additional resources to the enhancement of its risk management and assessment processes. The *Guide to Intervention for Federal Financial Institutions*, which was developed in 1995/96 in conjunction with the Office of the Superintendent of Financial Institutions (OSFI), is now consistently used by CDIC and OSFI in their common supervisory role.

The guide summarizes the timing of certain intervention measures and describes the co-ordination mechanism in place between OSFI and CDIC. CDIC also classifies provincially regulated institutions according to the guide's stages of intervention and uses the guide to classify member institutions that are on CDIC's watch list.

During the year, CDIC continued to refine another key risk management tool, namely its valuation model. The model consists of an extensive database and a sophisticated forecasting module and is

CDIC was able to allocate additional resources to the enhancement of its risk management and assessment processes.

Substantial progress was made in 1996 in rectifying deficiencies in almost all Standard areas.

used to analyse CDIC's exposure to high-risk institutions. More specifically, the model is used to assess the viability of problem companies and the effectiveness of the institutions' proposed solutions. In addition, CDIC uses the model to compare its potential loss under a liquidation with the loss under going-concern solutions, such as the facilitation of a sale process.

CDIC has been using this model as a risk management tool successfully since 1993. The model was greatly enhanced over the year in terms of its capacity to reflect the changing nature of the banking business. This year, for the first time, CDIC presented and shared the model with agencies of developing countries involved, or about to be involved, in deposit insurance and the supervision of financial institutions.

Standards Assessment and Reporting Program

CDIC's *Standards of Sound Business and Financial Practices* and the Standards Assessment and Reporting Program, known as SARP, have greatly contributed to CDIC's ability to better manage its risks.

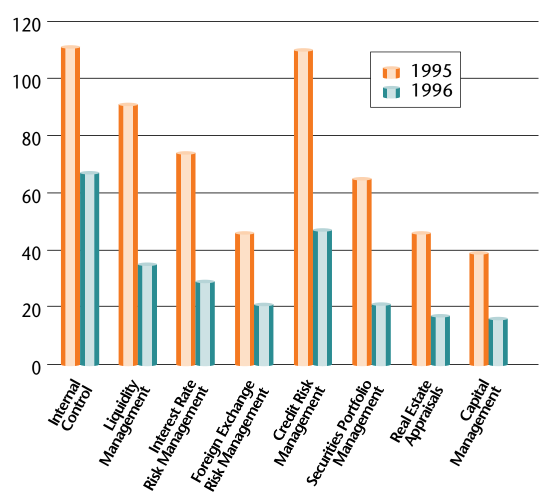
Under the SARP, CDIC member institutions are required to report each year on whether they are following CDIC's *Standards of Sound Business and Financial Practices*. SARP is designed to determine if each member has a well-defined program of policies and procedures in place with respect to each of the Standards, if the program is sound and prudent, and if the program is being adhered to.

Members are asked to assess themselves as at April 30 of each year and report on that assessment by completing either a simplified or a detailed report. The report must be provided to CDIC by July 31 of each year. The program commenced in 1995, and CDIC now has two years' worth of member reports for analysis.

Results for 1996 indicate that the efforts expended by member institutions in their 1995 self-assessments are beginning to pay off. Overall there was a 57 percent reduction in the number of deficiencies reported in 1996 versus 1995. The largest number of deficiencies reported by member institutions in 1995 was in the areas of internal control and credit risk management.

For the most part, the deficiencies identified by member institutions were readily correctable. In fact, substantial progress was made in 1996 in rectifying deficiencies in almost all Standard areas. Fewer companies reported deficiencies in each category of Standard in 1996 than in 1995, although internal control lagged behind the other areas.

FIGURE 7:
Number of Reported Deficiencies in 1995 and 1996 by Standard Area



For analysis purposes, CDIC groups the deficiencies into the following categories:

- Absence of board of directors oversight (pertaining to the review/approval of policies/procedures, ensuring the selection/appointment of qualified and competent management, and outlining the content and frequency of reporting, but excluding internal inspection/audit responsibilities);
- Shortcomings in internal inspection/audit;
- Deficiencies with respect to missing policy or control elements;
- Deficiencies in management information/reporting systems; and
- Other deficiencies (including risk measurement and miscellaneous activities).

The greatest improvement since the first SARP in 1995 has been in internal inspection/audit. Since an effective internal inspection/audit function is one component of the Internal Control Standard, one might expect deficiencies in the Internal Control Standard overall to show significant improvement. It is clear that, although deficiencies in internal inspection/audit may have received a great deal of attention, the other areas of the Internal Control Standard were not addressed as promptly.

CDIC will continue to monitor the self-assessments and examiners' reports closely to ensure that members are addressing outstanding deficiencies and following the Standards. To date, member institutions and CDIC have taken a co-operative approach to correcting Standards and related SARP deficiencies, and it is hoped this will continue. In the future, however, member institutions failing to address deficiencies in a timely fashion will be given shorter deadlines and, failing that, will face progressively more stringent action by CDIC. This may include the levying of premium surcharges and the termination of the policy of deposit insurance, if deemed necessary.

Adapting to Changes in the Legislative Environment

CDIC Premium By-law

Recent amendments to the CDIC Act require CDIC to make a premium by-law:

(a) to establish a system for classifying member institutions into different categories;

(b) to outline the criteria to be taken into account or the procedures to be followed by the Corporation in determining the category in which a member institution is classified; and

(c) to fix the amount of, or provide for the manner of determining the amount of, the annual premium applicable to each category.

To this end, CDIC is developing a differential premium system. Under this proposed system, member institutions would be classified into one of four categories according to a number of factors, which can be grouped into three broad categories: capital adequacy, other quantitative measures, and a CDIC qualitative rating. CDIC would assess different premiums for each category. However, the annual deposit insurance premiums would be limited to a maximum of one-third of one percent, as set out in the CDIC Act.

Differential premiums are not intended to be an actuarially based measure of the risk posed to the Corporation by an individual institution. Rather, they are intended to send an early warning signal—with financial consequences—to the management and board of directors of members institutions. The difference in premiums between

Differential premiums are intended to send an early warning signal to the management and board of directors of members institutions.

One of the most important aspects of the new legislation is a provision for eligible institutions to opt out of CDIC membership.

category 1, the best category, and category 4, the worst category, is intended to provide a meaningful incentive for member institutions to avoid excessive risk-taking. This incentive will be accomplished in two ways:

- Lower-rated institutions will pay higher premiums.
- Management discipline will be brought to bear on an institution's management and board of directors as a result of the knowledge respecting the categorization for differential premium purposes of their institution.

Given the present deficit circumstances, CDIC is proposing that initially, under the new premium by-law system, the annual deposit insurance premiums equal the revenues presently generated under the current, flat-rate system—even though different premiums would be charged to members in different categories.

CDIC is proposing an initial range of premiums from one-sixth of one percent of insured deposits for institutions in category 1 to one-third of one percent of insured deposits for institutions in category 4.

Once CDIC is in a position to reduce premium levels, consideration will be given to reducing the premium rates for institutions in category 1 while maintaining the maximum rate of one-third of one percent for institutions in category 4. This will increase the difference in premiums between categories, providing an even greater incentive for members to be classified in the best category.

Given the significance and impact of differential premiums on member institutions, the proposed premium by-law system will give member institutions the opportunity to appeal their rating and supply additional information to CDIC. As with other CDIC initiatives, the new system is being developed in consultation with regulators, member institutions and their associations, and other interested parties.

The premium by-law will be considered a regulation within the meaning of the *Statutory Instruments Act*. As such, the by-law will require review by the Department of Justice, Regulations Division, registration with the Clerk of the Privy Council, and publication in the Canada Gazette. In addition, the by-law must be approved by the Minister of Finance.

Policy and Legislative Environment Developments

CDIC played an active role in the development of new legislation for financial institutions during the past year as part of the 1997 review of financial sector legislation. From CDIC's perspective, one of the most important aspects of the new legislation is a provision for eligible institutions to opt out of CDIC membership. Under the new legislation, banks that, for all intents and purposes, serve only the wholesale market will be permitted to opt out of CDIC coverage, provided they are not affiliated with another CDIC member. As a result, these institutions will no longer have to fulfil the reporting requirements associated with CDIC membership. The impact on CDIC premiums is expected to be minimal since most of the institutions that may decide to opt out take few, if any, retail deposits and pay the minimum of $5,000 or only a small amount of premiums to CDIC.

CDIC is also participating in the Department of Finance's Payments System Advisory Committee during the next year to examine the key issues facing the payments system and to assist the government in determining whether adjustments to the system should be made.

CLAIMS AND RECOVERIES

CDIC is responsible for making deposit insurance payments, and it monitors its financial interests as a major creditor of member institutions that have failed. The Corporation provides information and leadership to ensure that effective and efficient practices are employed in every estate where CDIC has an outstanding claim. When appropriate, CDIC also conducts preparatory and special examinations of member institutions, including a review of their deposit liabilities and an analysis of their information and accounting systems.

CDIC has outstanding claims and loans (net of write-offs) of $768 million in 24 estates with assets totalling approximately $1 billion. During the year, CDIC recovered $362 million from claims and loans. This performance brings the total recoveries since 1991 to approximately $5.6 billion.

Initiatives in 1996/97

During the year, CDIC worked to improve claims and recovery performance by

- implementing a process of reviewing each liquidator's performance;
- introducing and applying standard estate performance measures;
- applying insured depositor service standards and developing an in-house PC-based deposit insurance payment system to calculate and make deposit insurance payments; and
- developing incentive plans that align the interests of liquidators and CDIC in optimizing recovery yields, and reducing costs and risks.

FIGURE 8:
Total Recoveries

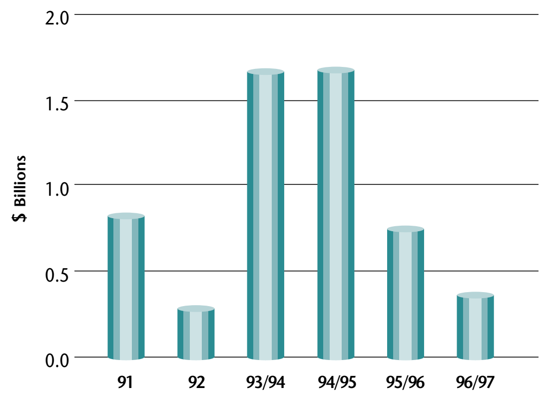
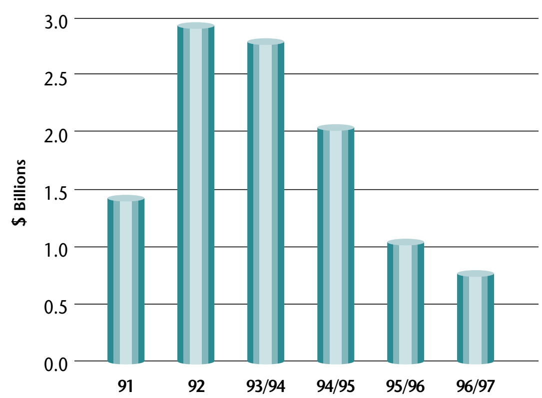


FIGURE 9:
Claims and Loans Receivable



Failure Resolution Methods

Liquidation/Payment of Deposit Insurance Claims

There are three instances where CDIC can make a payment of deposit insurance claims: when a court orders the deposits of a member institution frozen, when the regulator takes control of the institution, or when a winding-up order is issued. In such cases, CDIC may

Payments of insurance claims are generally completed within three to five weeks of the closure.

effect these insurance payments by issuing cheques directly to the insured depositors or by transferring the deposit insurance payment to another member institution. In so doing, CDIC is subrogated to the rights and interests of the insured depositors to the extent of the payment, which provides the basis for its claim. When a high proportion of deposits are insured, CDIC usually becomes the overwhelming creditor with a claim of 90 to 99 percent of the total claims filed within the estate.

When CDIC is required to pay insurance claims, CDIC independently calculates the insured deposit liability of the failed member, operates a depositor information line for both inquiries and claims, and in certain circumstances makes advance payments to insured depositors.

An important measure of CDIC's effectiveness in the eyes of depositors is the length of time between the date on which CDIC becomes obligated to pay insurance claims and the date full deposit insurance payments are made. The time required to make a full insurance payment depends upon many factors, including the extent of the preparatory work completed by CDIC, the size of the member's deposit base, the number of branches, the types of products the member offered, and the quality of the information systems used by the member. Payments of insurance claims are generally completed within 3 to 5 weeks of the closure, but have ranged from 1 to 10 weeks.

To make rapid and timely deposit insurance payments, CDIC has developed its own PC-based computer system. The system reduces CDIC's reliance on external suppliers for smaller payments, allowing better control over both the quality of service and the cost of providing it.

After payments of claims have been made, CDIC works with the liquidator's staff to determine the status of other claimants and to document the claim made by CDIC. Creditors must file what is known as a proof of claim with the liquidator to make a claim against the assets of the estate. This claim serves as the basis on which the liquidator calculates and makes distributions to creditors.

Alternatives to Liquidation

As an alternative to formal liquidation, CDIC may support transactions that compare favourably with the estimated cost to CDIC of a liquidation. Historically, CDIC has supported the following types of transactions:

- Purchase and assumption agreements, which involve the purchase of the failed member institution by another member.
- The organization of professionally-managed, single-purpose workout companies to realize upon problem assets.
- Agency agreements, whereby a CDIC member institution is appointed, for a fee, to manage the disposition of the failed member's assets and to pay its deposits and other liabilities as they come due.
- Deficiency coverage agreements, in which a third party acquiring impaired assets of a member institution is provided with a guarantee by CDIC to reduce the risk of loss on eligible assets.

In some cases, CDIC has provided loans to facilitate failure resolution. The most significant current loan involved total advances of $1,588 million to Adelaide Capital Corporation

(ACC), which acquired the residual assets of Central Guaranty Trust (CGT) not purchased by The Toronto-Dominion Bank in December 1992. As at March 31, 1997, CDIC had received $1,046 million from operations, and an additional $500 million—not reported in Table 1—from the refinancing of ACC's debt structure.

Estate Management

Liquidator/Manager Selection

An important element of the management of CDIC's claims and financial obligations is the selection or nomination of the estate liquidators or managers. For example, in member institution closures, CDIC is usually the most significant creditor. Typically, CDIC nominates a liquidator based on criteria that include CDIC's experience with the firm and the qualifications of the key individuals who will be assigned to the liquidation. The liquidator and CDIC then enter into an agreement, which provides CDIC with the opportunity to act in an ongoing advisory and monitoring capacity in the execution of the liquidation. In each estate, detailed billings are required from liquidators and their legal counsel in order to assess the efficacy of their stewardship of the estate.

Business Plans

Business plans are produced for each estate and are submitted in a report format requested by CDIC. Each plan reflects the liquidator's strategy for

- optimizing the recovery of assets;
- ensuring the employment of effective resources in prioritized and co-ordinated efforts; and
- establishing benchmarks for assessing progress and allowing the measurement of the liquidator's performance.

The liquidator's business plan reviews the history leading up to the failure. It includes balance sheets, income statements, cash-flow projections, and various asset-related and economic assumptions. The plan also outlines the litigation issues, the quality of the assets, the information systems in place, and any other important features related to the estate. The liquidator must ensure that the claim amounts and legal rights asserted by the various creditors are reviewed and validated. CDIC reviews the liquidator's first business plan in detail and presents it to its Real Estate Advisory Panel, among others.

Claims

CDIC needs to recover its costs and insurance payments by pursuing a claim against the estate of the failed institution. CDIC's recoveries and associated losses are closely tied to the relative ranking of its claim to the claims of other creditors. For example, in some estates secured creditors' claims have priority over CDIC's unsecured claims, resulting in increased loss to CDIC. In addition, disputed claims for reasons of validity or priority—and lawsuits against the entity or against specific assets—affect the estate's ability to dispose of the assets and manage costs. This directly affects CDIC's recoveries since the liquidator or manager of the estate cannot make the final distribution to the creditors and conclude the estate's affairs until all claims and other legal issues are resolved. As a result, considerable cash is, at times, held in estates with litigation issues. Currently, approximately 70 percent of all estates have non-asset, claims-related or litigation issues.

In member institution closures, CDIC is usually the most significant creditor.

TABLE 1:

CDIC's Claims, Recoveries, and Losses on Member Institutions in Liquidation

Non-Cash Assets Liquidated as a Percentage of Total Non-Cash Assets — Year of Failure	Total Claims and Loans	Recoveries to March 31, 1997		CDIC's Projected Loss	
	($ millions)	($ millions)	as % of Total Expected	as % of Claims and Loans	NPV[1] as % of Claims and Loans
More than 99% of Non-Cash Assets Liquidated					
Crown Trust Company – 1983	930	929	99%	0%	2%
Dominion Trust Company – 1993	431	353	98%	16%	20%
Fidelity Trust Company – 1983	792	437	99%	44%	51%
Greymac Mortgage Corp./Greymac Trust Co. – 1983	414	206	99%	50%	63%
Northland Bank – 1985	321	203	93%	31%	66%
Pioneer Trust Company – 1985	201	172	98%	12%	31%
Seaway Trust Co./Seaway Mortgage Corp. – 1983	420	362	99%	13%	47%
Between 95%-99% of Non-Cash Assets Liquidated					
AMIC Mortgage Investment Corporation – 1983	28	15	93%	42%	65%
Bank of Credit and Commerce Canada – 1991	22	20	98%	11%	25%
CCB Mortgage Investment Corporation – 1985	123	109	96%	7%	27%
Prenor Trust Company of Canada – 1993	820	774	99%	5%	7%
Saskatchewan Trust Company – 1991	64	56	98%	10%	19%
Settlers Savings & Mortgage Corporation – 1990	84	60	93%	23%	27%
Shoppers Trust Company – 1992	492	426	90%	4%	16%
Standard Loan Co./Standard Trust Co. – 1991	1,321	1,039	95%	17%	33%
Between 80%-95% of Non-Cash Assets Liquidated					
Confederation Trust Company – 1994	680	604	87%	(2%)	0%
Income Trust Company – 1995	193	151	88%	11%	21%
Monarch Trust Company – 1994	65	58	94%	6%	13%
Principal Savings and Trust Company – 1987	116	99	66%	(29%)	19%
Less than 80% of Non-Cash Assets Liquidated					
Adelaide Capital Corporation (CGT/TD) – 1992	1,758	1,046	70%	5%	12%
Security Home Mortgage Corporation – 1996	42	10	31%	24%	N/A
Total	**$9,317**	**$7,129**	**90%**	**13%**	**24%**

[1] *All cash flows are discounted on an annual basis using CDIC's weighted average costs of funds.*

Asset Management and Disposition

CDIC brings three important objectives to asset management and disposition. First, CDIC uses a concept of risk minimization that includes two major elements: minimizing the effect of interest rate fluctuations on the value of the financial assets of estates, and recognizing the effect of real estate cycles on the assets. Second, CDIC promotes methods of enhancing receipts and reducing costs wherever possible by encouraging liquidators to consider different approaches to managing the various components of a liquidation, including sub-contracting. Third, CDIC supports efforts to maximize the net present value (NPV) of recoveries from the estate.

The NPV concept considers the borrowing cost implicit in holding a claim; it recognizes that, assuming the same amount of recovery, it is better for CDIC to receive the funds sooner rather than later, especially since a significant component of CDIC's loss on its claims is the interest cost on funds borrowed. NPV recovery calculations are based on cash flows and are affected by interest rate variations, changes in the timing and amount of recoveries, and changes in general market forces. In most estates, total expected recoveries do not cover the original claim amount, resulting in a loss for CDIC. Table 1 illustrates the large variance in CDIC's recovery rates and presents CDIC's experience of losses on its claims.

Asset Composition

Neither CDIC nor estate managers have control over the mix of assets they are presented with at the outset of a liquidation. Many of the assets are difficult to convert into cash, a fact that is typically related to the failure of the institution in the first place. At December 31, 1996, approximately 56 percent of non-cash assets were "performing" assets of relatively high quality requiring minimal efforts to sell. Forty-four percent of non-cash assets in estates were "sub- and non-performing" assets consisting of below-grade loans with varying marketability and requiring considerable effort to sell or collect. Mortgages and most of the loans are secured by real estate widely distributed across Canada, as shown in Figure 11. Liquidating these and other assets is a function of the quality of the assets, market conditions, and the skill of the vendors. At December 31, 1996, approximately 80 percent of the assets under administration were in only six estates.

Incentive Remuneration Plans

Holding portfolios of assets for an extended period of time is an alternative to en bloc sale or early disposition. However, only when CDIC is provided with strong evidence that

FIGURE 10:
Assets Under Administration

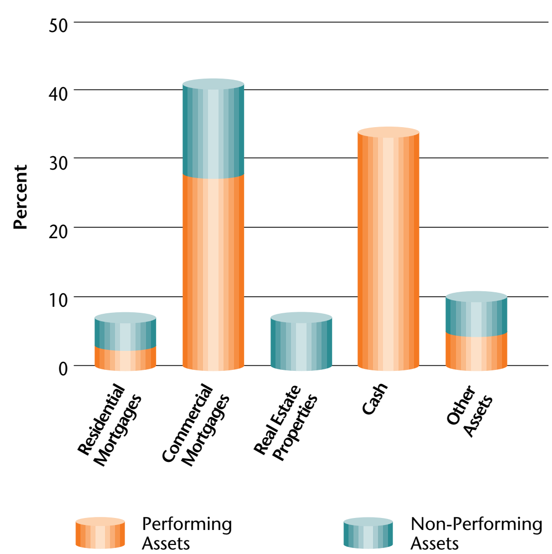
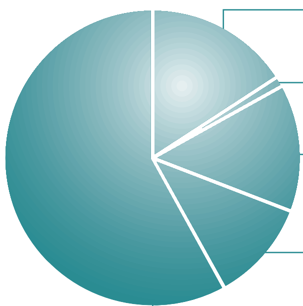


FIGURE 11:
Geographical Distribution of Non-Cash Assets in Estates



the outcome will be superior to the immediate disposition of the assets will it support the proposal for longer-term workouts. Often this evidence is difficult to gather since the outcome may be uncertain and dependent on forces outside the control of the liquidator.

When CDIC supports a workout, it may consider a scheme involving an incentive plan that

- aligns the economic interests of the liquidator more closely with those of the claimants; and
- distributes in some proportion the risks and rewards of realizing on the assets by making the remuneration of the liquidator dependent on the amount and timing of realizations. In this case, the liquidator agrees to set aside its normal fee schedule in exchange for remuneration based on the outcome.

Litigation Management and Legal Issues

In the legal area, CDIC deals with a broad cross-section of complex matters, which involve many areas of law.

As a large creditor of financial institutions in liquidation, CDIC scrutinizes the management of legal and litigation issues in each estate to ensure that costs are controlled, that proper planning and assessments of net potential benefits are undertaken, and that activities are refined or curtailed at appropriate times.

For the purposes of assessing the performance of liquidators, legal issues can be grouped into three general categories:

- asset management and disposition matters, which include realizing on estate assets such as mortgage collection proceedings and asset-related litigation;
- claims-related matters, including claims of would-be creditors that have been disallowed and priority disputes with respect to claims, which ultimately can have a significant impact on CDIC's recoveries; and
- litigation matters, including forensic fact-finding investigations and possible claims by liquidators—and in some cases by CDIC—against parties that may have caused a loss to the estate.

In the case of forensic matters, in circumstances where the Corporation has suffered losses and there is information that raises a reasonable case of negligent or willful misconduct or wrongdoing by directors, officers or auditors, or by other relevant parties, the Corporation is committed to taking appropriate legal action—either directly or through liquidators, or both. In common with the liquidator and other stakeholders, CDIC wishes to see the maximum recovery, but also is interested in broader issues, such as discipline, credibility, fairness, consistency, and stability. Very rough estimates of the recoveries through such litigation obtained to the end of 1996 indicate that in excess of $150 million has been paid to CDIC, estates in liquidation, and other creditors.

Estate Performance

CDIC has various methods of measuring, monitoring, and encouraging estate performance to achieve the Corporation's goals. These include the application of performance measures in such areas as deposit insurance payment and estate management.

Deposit Insurance Payment Standards

Customer service standards have been developed to ensure that CDIC responds to the needs of insured depositors. These standards are described in Table 2. Below, CDIC reports its performance against them for the first time this year.

During 1996, CDIC made payments to insured depositors of Security Home Mortgage Corporation (SHMC) subsequent to its failure in June 1996. SHMC held 2,647 accounts totalling $42.1 million for 2,352 customers. By value, 99.9 percent was insured. Advance payments of deposit insurance totalling $0.2 million were made by CDIC. CDIC effected the payment of insured deposits by making a bulk payment to National Bank of Canada, which set out accounts for each of the SHMC depositors with deposit insurance payments. National Bank was chosen as a result of a tendering process. Depositors were provided access to their insurance payments within 20 days of SHMC's failure—well within CDIC's target for the deposit insurance payment duration of a small institution.

Customer service standards were successfully attained during the payment of deposit insurance claims in SHMC. Within 24 hours of SHMC's closure, CDIC's general information telephone lines were open; within five days, CDIC provided depositors with information on deposit insurance coverage and the deposit insurance payment process. The Corporation provided cheques for advance payments and responded to depositor requests within 24 hours of each request. Results of a survey of depositors indicated that customer satisfaction was very high with "good" or "excellent" ratings in the various service categories ranging from 88 percent to 96 percent of respondents. This high level of service was achieved at a net cost of just over $2 per account, which represents just 15 percent of the 1994/95 cost of $13 per account.

Estate Management Performance Measures

CDIC reviews estate management with respect to such issues as the closure of the financial institution, cash management, compliance with the terms of the nomination letter, asset and claim management, and legal matters, especially forensic and director, officer, and auditor liability. This performance is documented and discussed in periodic meetings with each liquidator's senior partner. Such meetings provide an opportunity for CDIC to share its institutional memory and expertise as well as to discuss topics of mutual interest with liquidators.

Claims Performance

In order to measure claim performance, CDIC compares the net present value of the actual claim recoveries with the NPV of the projected entitlement to CDIC. In addition, CDIC monitors the speed with which the liquidator progresses towards the final cash distribution in an estate and calculates CDIC's projected loss on a nominal and NPV basis, as presented in Table 1.

Asset Realization Performance

Asset realization performance is a function of many interrelated factors, most notably realizations relative to expected value, duration of the realization process, and claims by the estate for the recovery of damages. Moreover, each estate has unique attributes that directly affect its ability to dispose of assets and manage costs. These include asset quality and portfolio composition by product and geographical dispersion, market cycles in general and those specific to a product or region, the quality of the staff, management and systems in place at the failed institution at the time of failure, claims and litigation against the entity generally or against specific assets, and the quality of the estate operator's stewardship. Based on these factors, the percentage of actual recoveries against expected recoveries, as set out in the liquidator's business plan on an NPV basis, is a key indicator of the liquidator's performance in the recovery process.

TABLE 2:

Customer Service Standards for Depositors Should the Payment of Deposit Insurance Be Necessary

Service Standards

Communications

- CDIC will provide telephone assistance in English and French and will use its best efforts to provide telephone assistance in any other preferred language of a depositor.
- CDIC will provide service in a professional, courteous, and understanding manner.
- Within five days of the closure of a member institution, CDIC will provide depositors with information on deposit insurance coverage and the deposit insurance payment process.
- Within two weeks of closure, CDIC will inform depositors of the deposit insurance payment process, including the expected date and method of making the deposit insurance payment.
- If necessary, pursuant to CDIC's Joint and Trust Account Disclosure By-law, CDIC will contact depositors holding joint and trust accounts to request required information no later than 10 days after the closure of a member institution.

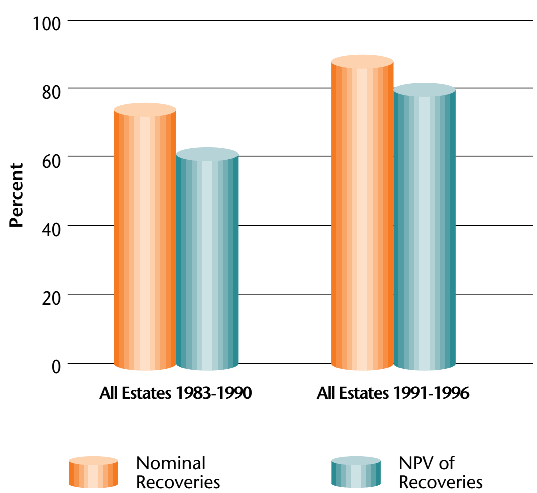
Payments

- From time to time, CDIC may receive approval for making payments of insurance to depositors in need of their funds before CDIC is positioned to make a general deposit insurance payment. When advance payments are approved, CDIC will process requests from depositors and either respond or issue cheques to them within 24 hours of receiving the request.
- CDIC will use its best efforts to arrange for the transfer of registered deposits (RRSPs, RRIFs) to another trustee in accordance with the *Income Tax Act* (Canada), such that there will be no negative tax consequences as a result of a loss of registration.
- CDIC will provide depositors with a detailed statement of account with the deposit insurance payment made by cheque. Should CDIC make the payment by transfer to another member institution, CDIC will provide the depositor with a statement no later than three days before the date of the payment.
- CDIC will complete the payment of deposit insurance claims in such a way as to meet or exceed the target performance measures (which include both the time required to make deposit insurance payments and the cost of doing so) contained in CDIC's 1995/96 – 1999/2000 *Corporate Plan*.

Yields on Recoveries

Recovery yields on claims against estates in liquidation have increased since 1991. This is due to a variety of factors. The cumulative experience and expertise of insolvency practitioners from the legal and public accounting communities and earlier intervention by regulators and CDIC have played a large part in controlling costs and increasing recoveries.

FIGURE 12:
Recoveries as a Percentage of Claims and Loans



In addition, improved recovery yields have resulted from adopting different strategies for different groups of assets. By way of example, as part of the resolution of the failure of Financial Trust Company in 1988, MECI Properties Inc. (MECI) was established to work out and realize upon the problem assets not purchased by Central Guaranty Trust Company. CDIC contributed to the original financing of MECI by purchasing $74 million in subordinated debentures. In July, 1996, the distress preferred share refinancing of MECI Properties Inc.—which had repaid CDIC's subordinated debentures—matured. At that time, the shares, redemption of which CDIC had guaranteed, were redeemed from the proceeds of disposition of certain assets of MECI and related companies. CDIC suffered no loss of principal or interest on its loan to MECI, and avoided the expense of a $1 billion payment of deposit insurance claims. MECI Properties Inc. has been wound up.

Where appropriate, improved recoveries have been achieved by accelerating the disposition of assets within the first year of liquidation. Recent experience in recoveries indicates that this strategy has contributed to CDIC's goal of optimizing its recoveries, as earlier disposition often results in lower net interest costs and minimizes exposure to future risk.

Estate Overhead

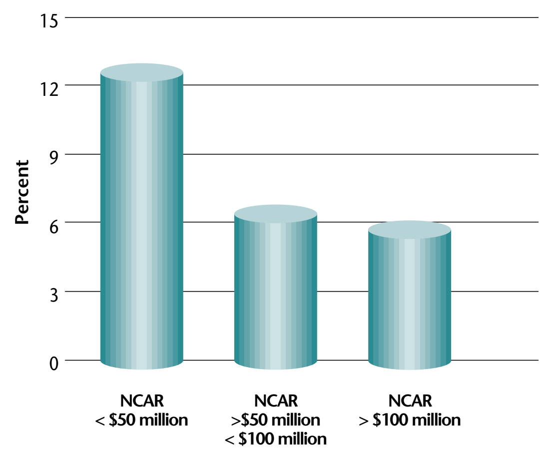
The costs of managing estates are affected by the quality of the assets and by the management of claims, lawsuits, and other non-asset-related costs. As the total assets under administration have declined in recent years, so too have liquidator staffing levels and overhead costs. For example, since 1993 total assets under administration have declined from $3.4 billion to approximately $1.0 billion; the number of full-time equivalent staff employed in liquidations has declined from 370 to approximately 85; and overhead costs have declined from $42 million to $32 million.

Recovery yields on claims against estates in liquidation have increased since 1991.

An indicator of efficiency may be calculated from a comparison of costs with realizations but a number of qualitative considerations must also be factored into performance expectations. The total overhead costs of liquidations vary considerably from one institution to another because of the different circumstances of each failure. Total overhead costs currently range between 2 and 25 percent of non-cash asset realizations, with a weighted average of 5 percent. As presented in Figure 13, the size of the estate affects performance, particularly when an estate is small and economies of scale may be unavailable.

FIGURE 13:

Estate Overhead Costs as a Percentage of Non-Cash Asset Realizations (NCAR)



CORPORATE MANAGEMENT

Planning and Accountability

CDIC's planning and accountability framework, shown in Figure 14, is based on the Corporation's statutory objects. The Corporation's mission statement was developed directly from these objects. Together, the statutory objects and the mission statement act as a base for determining the Corporation's priorities and business strategies.

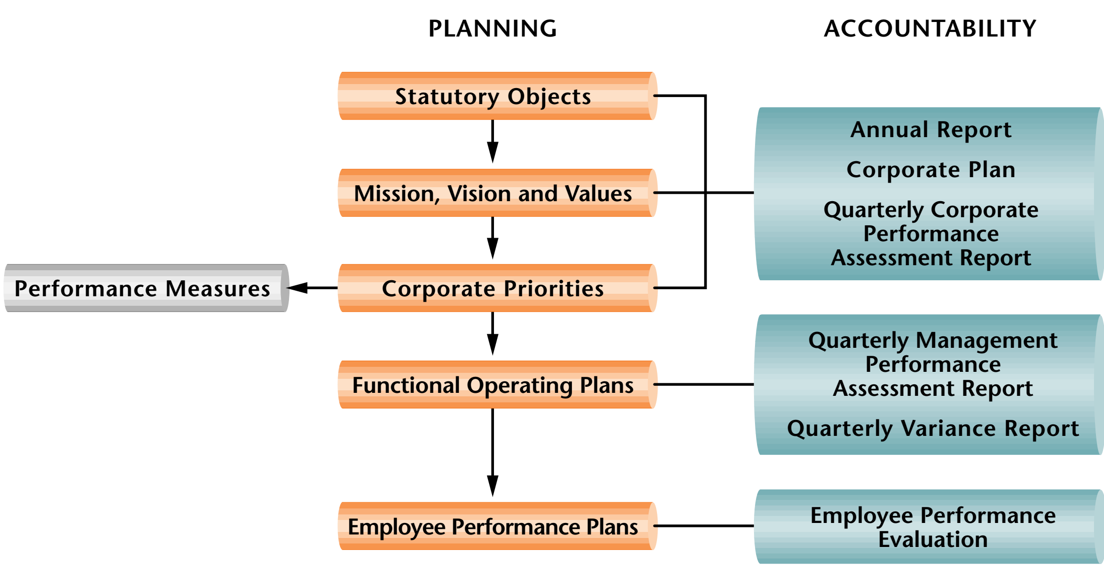
Corporate planning involves developing CDIC's strategic and operational plans as well as the annual operating and capital budgets. CDIC's overall strategic direction is established by the Board of Directors.

Accountability is an essential element of the corporate management process. As a Crown corporation, CDIC is held accountable to Canada's Parliament through the Minister of Finance. Accountability for achieving the objects and priorities is communicated by two major corporate documents: the *Annual Report* and the

CDIC's mission is to provide deposit insurance and to contribute to the stability of the financial system in Canada in a professional and innovative manner, meeting the highest standards of excellence, integrity and achievement, for the benefit of depositors of member institutions while minimizing the Corporation's exposure to loss. CDIC will provide an environment wherein employees are treated fairly and given opportunities and encouragement to develop their maximum potential.

FIGURE 14:

Planning and Accountability Framework



Corporate Plan. In addition, an internal document, the corporate Performance Assessment Report, which summarizes CDIC's financial performance as well as the impact of departmental activities on the achievement of the corporate priorities, is presented at each Board meeting. In order to get a true ongoing picture of CDIC's performance and direction, the *Annual Report* and the *Summary of the Corporate Plan* should be read as a related set of documents.

Performance measures are a tool used to measure success against the overall business strategy. Over the past few years, CDIC has developed and refined a number of measures that attempt to reflect CDIC's key business areas. CDIC is now in the process of identifying meaningful new performance indicators for future use. Measures currently in place include the cost per account of paying deposit insurance claims, the time per account required to pay the deposit insurance claims, the percentage of operating costs to premium revenue, the turnover rate of employees, and the absenteeism rate of employees.

Business Model

Figure 15 presents CDIC's Business Model. This model is not an organizational chart but a cross-departmental illustration of CDIC's business processes undertaken to achieve the priorities. The corporate management, primary, and secondary functions represent the activities across all divisions.

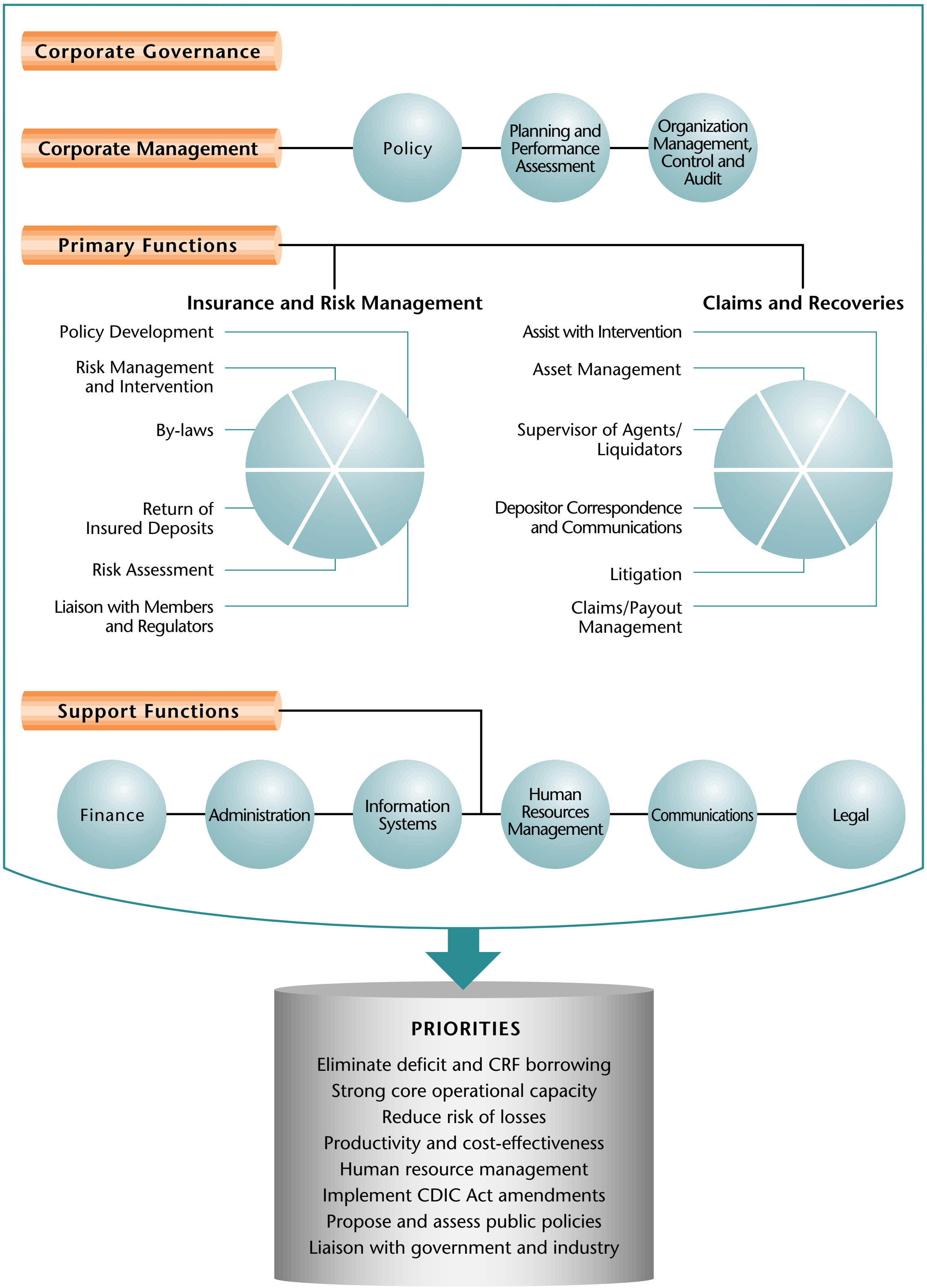
Finance

CDIC's Finance Division is responsible for the accounting, corporate planning (in co-operation with the Executive Office), financial planning, and treasury activities of the organization. It is responsible for the annual financial statements and CDIC's financial plans and budgets, which are encapsulated annually in the five-year *Corporate Plan*. Finance ensures the integrity of the financial affairs of the Corporation by maintaining proper financial systems and records and establishing appropriate internal controls to protect the Corporation's assets. The division also reports regularly to the Board of Directors on CDIC's results in achieving its priorities.

On June 28, 1996, the CDIC Act was amended to provide CDIC with the ability to borrow from public markets to fulfil its debt requirements. After consultations between CDIC and the Department of Finance, the Minister of Finance set the terms and conditions and the administrative processes for CDIC's transition to capital-market activity. Included in these conditions was a requirement that CDIC pay the Receiver General a credit enhancement fee on new borrowings or on any borrowings that are on CDIC's books as at April 1, 1999. The calculation of the fee will be based on objective criteria that exist at the time the capital market activity takes place.

Although the Corporation does not forecast the need for any market borrowing over the five-year planning horizon, it has developed an internal infrastructure to manage such a process. Appropriate policies, which govern treasury-related activities and address the risks to which CDIC may be exposed as a result of these activities, have been put in place and approved by the Board of Directors. The treasury infrastructure calls for an active role to be played by the Asset/Liability Management Committee and for the creation of a risk management unit to meet the control requirements promulgated by the Minister of Finance in his recently issued *Financial Risk Management Guidelines for Crown*

FIGURE 15:
CDIC Business Model



Corporations. Another initiative undertaken this year was training for members of the aforementioned committee and members of the Finance Division who will be involved in the treasury area. Finally, the Corporation has begun developing its treasury information systems with the expectation that appropriate reporting will be in place by mid-1997.

Administration

The administration function is fulfilled by the Corporate Services Division. In addition to the functions of information systems, human resources management, and communications, outlined below, the division is responsible for all aspects of CDIC's sites and internal operations.

Information Systems

As a result of a restructuring within the Corporate Services Division, the areas responsible for records management, system development, and technical support have been merged into one department: Information Systems.

During the year, Information Systems designed a system to support the pre-clearance of member institutions' deposit products, which is part of the Deposit Insurance Information By-law. The department is currently reviewing its practices for handling corporate records. The review encompasses storage and retrieval methods and will include information held either in hard copy or electronically. The department also continues to support CDIC's computer network and office automation tools and is reviewing the existing technical environment to ensure that CDIC's future business needs will be met.

A project undertaken by CDIC, OSFI, and the Bank of Canada and sponsored by the Financial Institutions Supervisory Committee to study the processes for collecting, verifying, retaining, and distributing financial information was completed. The study concluded that although the processes were adequate, the three organizations should consider changing the computer platform to take advantage of more modern technologies. CDIC, OSFI, and the Bank of Canada have agreed to proceed with the recommendation, and the project is expected to be completed in the fall of 1998.

Human Resources Management

In the spring of 1996, the Treasury Board wage restraint policy was modified to permit the resumption of in-range salary adjustments and the payment of performance bonuses. Accordingly, in May 1996, the Board of Directors, upon recommendation of the Employee Relations Committee, approved salary adjustments effective June 15, 1996. As well, the Board of Directors approved the payment of performance bonuses consistent with the Corporation's compensation policy. In 1997, CDIC will be conducting a market comparison of salaries paid by similar organizations to see if any movement of the salary policy line is required.

As a Crown corporation, CDIC is required to meet statutory requirements with respect to employment equity, official languages, multiculturalism, and health and safety and report on its compliance with these requirements to the respective overseeing bodies.

CDIC continued to implement the infrastructure necessary for sound human resources management. New policies on official languages, compressed work week, smoking in the workplace, employee recognition, and compensation were issued during the year, and a new Human Resources Policies Manual containing all the current human resources policies was distributed. In addition, each employee received a booklet, *Understanding Your Salary*, which describes the links between compensation, job evaluation, and the performance management policy.

A second employee survey was conducted in November 1996. The results show an organization that has seen progress and improvement since the first survey conducted in 1994. Almost all areas in which this year's results could be compared with those of 1994 show an improvement, and in some cases the improvement was considerable.

Recognition is a process that enhances employee effectiveness by identifying and highlighting exceptional contributions. This year, 25 employees received employee recognition awards for their significant contribution to CDIC.

The Corporation continued to develop its corporate training program, which included office automation training, stress management training, management development, executive development programs, official languages training, health and safety training, and a well-received "infolunch" series.

Communications

In an effort to streamline the overall communications function, the Communications and Public Affairs Department was restructured in 1996 to include responsibility for Linguistic and Publishing Services. This has resulted in efficiencies in budgeting and in delivery of the Corporation's messages to its various stakeholders. In addition, policies were developed to help manage internal and external communications effectively.

Internal communications guiding principles were developed during the year to provide a framework for CDIC's internal communications plan. These principles strongly reflect two of CDIC's corporate values: communication and teamwork. The principles are intended to contribute to the effective management and operation of the Corporation by building a shared understanding of effective communication.

CDIC launched its Web site in January 1997 as a means of providing information on deposit insurance to stakeholders more widely, more efficiently, less expensively, and on a more up-to-date basis. The address is http://www.cdic.ca. In addition to obtaining detailed information on deposit insurance and accessing a current list of CDIC member institutions, site visitors can test their knowledge of deposit insurance through an interactive multiple-choice quiz, browse an electronic library of news releases and other CDIC publications, and contact CDIC via E-mail to request additional information. During its first three months of operation, CDIC's Web site logged more than 11,000 hits from over 1,700 visitors.

The CDIC toll-free information line responded to approximately 13,000 inquiries during the year, with about 10 percent of the calls coming from employees of member institutions. This trend will no doubt continue with the full implementation of the Deposit Insurance Information By-law in March 1998. Information on deposit insurance was also provided through the distribution of more than 1.3 million copies of the CDIC

Information and Membership brochures. Feedback from our stakeholders on the quality of service CDIC provides continued to be very positive.

Legal

The overall legal function is satisfied by the Legal Division and Corporate Secretariat. The Legal Division provides legal advice and support throughout CDIC, directly and through retained counsel. In doing so, a major focus has necessarily been on supporting the primary functions of insurance and risk management and claims and recoveries. At the same time, the division supports CDIC's operational infrastructure and legal and institutional framework and requirements.

The Corporate Secretariat serves as a primary resource and support for the Chairperson and the Board of Directors.

Over the past year, advice and support was provided respecting the following: problem institutions, litigation and forensic work, by-law development—including the Deposit Insurance Information By-law, the infrastructure for this by-law, and the Premium By-law—CDIC Act amendments, and treasury policies.

During the 1996/97 fiscal year, fees in the order of $1.9 million were paid to law firms for their work for CDIC. This compares with fees of some $2.0 million for the previous year and also compares with fees of some $10.1 million paid by liquidators to law firms (and associated, correspondent, or agent firms) in 1996/97 for work in connection with estates where CDIC is a creditor.

Audit

The audit function is addressed by the Audit and Consulting Services Department, which is responsible for assessing, on an ongoing basis, CDIC's compliance with the requirements of the *Financial Administration Act* and for determining if CDIC keeps books and records and maintains systems and practices that provide assurance that

- assets are safeguarded and controlled;
- transactions are in accordance with specified authorities;
- resources are managed economically and efficiently; and
- operations are carried out effectively.

In order to fulfil its responsibilities, the Audit and Consulting Services Department requires independent status and therefore reports directly to the President and Chief Executive Officer and to the Audit Committee of the Board of Directors.

During the past year, in addition to the annual audits of the accounting systems and tests for compliance with authorities, the department performed reviews of the Insurance and Risk Assessment Division, corporate security, and the records/information management function. The department was also actively involved in monitoring and reporting on systems development projects, managing an audit of claims made under a deficiency coverage agreement, and assisting in the attest audit performed by the Office of the Auditor General.

MEMBERSHIP PROFILE — 1992 - 1996

The following profile provides comparative information on CDIC's membership for the last five years. The profile is not intended, in any way, to reflect or otherwise comment on risk to CDIC. The profile has been prepared from data supplied by the members themselves through the Bank of Canada, the Office of the Superintendent of Financial Institutions and the Ontario Ministry of Finance, and from data received directly by CDIC from provincial members. Every effort has been made to ensure the correctness of the compilation; however, because the data come from varied sources, CDIC does not guarantee their accuracy.

In providing such information, CDIC is limited by the availability of the data in a readily accessible format and by confidentiality requirements. It should be noted that the data present aggregates and averages, and, as such, within the aggregates and averages the data for individual members can vary significantly. In addition, off-balance sheet activities, including estate, trust and agency business, are not included in the data.

The membership data have been classified into five major peer groups: domestic banks and their subsidiaries, foreign bank subsidiaries, trust and loan companies and their subsidiaries, the deposit-taking subsidiaries of life insurance companies, and affiliates of caisses populaires and credit unions. These peer groups reflect different characteristics established by incorporating and governing legislation, and regulatory frameworks. When viewing these peer groups, readers should note that some members could be classified in more than one group.

The information and data compiled are presented as follows:

1.0 Members and their regional location

2.0 Summary financial information — total CDIC membership

3.0 Asset size and quality measures — member peer groups

4.0 Deposit liabilities

5.0 Capitalization measures

6.0 Income and profitability measures

7.0 CDIC premiums

Note: *The following tables (with the exception of Tables 5.2 and 7.0) exclude the financial data of institutions that were no longer members as at March 31, 1997.*

1.0 Members and Their Regional Location

1.1 CDIC Members as at March 31, 1997[1]

Domestic Banks and Subsidiaries

Bank of Montreal
Bank of Montreal Mortgage Corporation
Trust Company of Bank of Montreal (The)
Bank of Nova Scotia (The)
Bank of Nova Scotia Trust Company (The)
Montreal Trust Company
Montreal Trust Company of Canada
Scotia Mortgage Corporation
Canadian Imperial Bank of Commerce
CIBC Mortgage Corporation
CIBC Mortgage Inc.
CIBC Trust Corporation
Canadian Western Bank
Canadian Western Trust Company
National Bank of Canada
General Trust of Canada
Natcan Trust Company
Royal Bank of Canada
Royal Bank Mortgage Corporation
Royal Trust Company (The)
Royal Trust Corporation of Canada
Toronto-Dominion Bank (The)
First Nations Bank of Canada
TD Mortgage Corporation
TD Pacific Mortgage Corporation
TD Trust Company

Total: 26

Foreign Bank Subsidiaries

ABN AMRO Bank Canada
Amex Bank of Canada
Banca Commerciale Italiana of Canada
Banco Central Hispano-Canada
Bank of America Canada
Bank of China (Canada)
Bank of East Asia (Canada) (The)
Bank of Tokyo-Mitsubishi (Canada)
Banque Nationale de Paris (Canada)
BT Bank of Canada
Chase Manhattan Bank of Canada (The)
Cho Hung Bank of Canada
Citibank Canada
Crédit Lyonnais Canada
Credit Suisse First Boston Canada
Dai-Ichi Kangyo Bank (Canada)
Deutsche Bank Canada
Dresdner Bank Canada
First Chicago NBD Bank, Canada
Fuji Bank Canada
Hanil Bank Canada
Hongkong Bank of Canada
HongkongBank Mortgage Corporation
Hongkong Bank Trust Company
Industrial Bank of Japan (Canada) (The)
International Commercial Bank of Cathay (Canada)
J. P. Morgan Canada
Korea Exchange Bank of Canada
Mellon Bank Canada
National Bank of Greece (Canada)
National Westminster Bank of Canada
Paribas Bank of Canada
Republic National Bank of New York (Canada)
Sakura Bank (Canada)
Sanwa Bank Canada
Société Générale (Canada)
Sottomayor Bank Canada
State Bank of India (Canada)
Sumitomo Bank of Canada (The)
Swiss Bank Corporation (Canada)
Swiss Bank Corporation Trust
Tokai Bank of Canada
Union Bank of Switzerland (Canada)
United Overseas Bank (Canada)

Total: 44

[1] *Member institutions with common affiliation have been grouped together, starting with the member having the largest assets and then in alphabetical order.*

Trust and Loan Companies, and Subsidiaries

AGF Trust Company
Canada Trustco Mortgage Company
Canada Trust Company (The)
Effort Trust Company (The)
Equitable Trust Company (The)
Evangeline Trust Company
Fortis Trust Corporation
Granville Savings and Mortgage Corporation
Home Savings & Loan Corporation
Household Trust Company
ING Trust Company of Canada
Investors Group Trust Co. Ltd.
London Trust & Savings Corporation
M.R.S. Trust Company
Merchant Private Trust Company (The)
MTC Mortgage Investment Corporation
National Trust Company
Victoria and Grey Mortgage Corporation
Northern Trust Company, Canada (The)
Pacific & Western Trust Corporation
Peace Hills Trust Company
Peoples Trust Company
State Street Trust Company Canada
Trimark Trust

Total: 24

Life Insurance Subsidiaries

Bonaventure Trust Inc.
Manulife Bank of Canada
Mutual Trust Company (The)
Sun Life Trust Company
Sun Life Savings and Mortgage Corporation
Trust Company of London Life (The)

Total: 6

Caisses Populaires and Credit Union Affiliates

Citizens Bank of Canada
Citizens Trust Company
Civil Service Loan Corporation
Co-operative Trust Company of Canada
Community Trust Company Ltd.
Laurentian Bank of Canada
Desjardins Trust Inc.
Laurentian Bank Savings and Mortgage Corporation
Laurentian Trust of Canada Inc.
League Savings & Mortgage Company

Total: 10

TOTAL: 110 members

1.2 Membership Changes: April 1, 1992 - March 31, 1997

New Members

September 11, 1992:	MTC Mortgage Investment Corporation
September 30, 1992:	Bank of East Asia (Canada) (The)
October 14, 1992:	Bank of Nova Scotia Trust Company (The)
October 14, 1992:	TD Trust Company
October 29, 1992:	Civil Service Loan Corporation
November 11, 1992:	Laurentian Bank Savings and Mortgage Corporation
November 11, 1992:	Natcan Trust Company
November 11, 1992:	Trust Company of Bank of Montreal (The)
January 27, 1993:	Bank of China (Canada)
March 3, 1993:	RBC Trust Company
August 11, 1993:	U.S. Bank (Canada)
January 26, 1994:	Northern Trust Company, Canada (The)
September 14, 1994:	General Trust of Canada
May 2, 1995:	State Street Trust Company Canada
December 13, 1995:	Trust Company of London Life (The)
May 22, 1996:	Swiss Bank Corporation Trust
December 4, 1996:	ING Trust Company of Canada
December 4, 1996:	First Nations Bank of Canada
January 22, 1997:	Citizens Trust Company

Other Membership Changes *(Name changes excluded)*

April 8, 1992:	Bank of New York Canada ceased operations — policy cancelled.
April 8, 1992:	The First National Bank of Chicago (Canada) ceased operations — policy cancelled.
June 17, 1992:	Guardian Trust Company ceased to accept deposits — policy cancelled.
August 6, 1992:	Guardcor Loan Company ceased to accept deposits — policy cancelled.
October 30, 1992:	Citibank Canada Mortgage Corporation amalgamated with Citibank Canada — continuing as Citibank Canada.
November 25, 1992:	The Dominion Trust Company amalgamated with Security Trust Company — continuing as The Dominion Trust Company.
December 1, 1992:	Laurentian Bank of Canada Mortgage Corporation ceased to accept deposits — policy cancelled.
December 30, 1992:	National Bank Mortgage Corporation ceased to accept deposits — policy cancelled.
December 31, 1992:	Bank of America Canada amalgamated with Security Pacific Bank of Canada — continuing as Bank of America Canada.
December 31, 1992:	Focus National Mortgage Corporation ceased to accept deposits — policy cancelled.
December 31, 1992:	The Toronto-Dominion Bank acquired most of the assets and assumed the deposit liabilities of Central Guaranty Trust Company and Central Guaranty Mortgage Corporation.

January 1, 1993: Cabot Trust Company, Regional Trust Company and Huronia Trust Company amalgamated — continuing as Manulife Bank of Canada.

April 6, 1993: General Trust Corporation of Canada ceased to accept deposits — policy cancelled.

April 30, 1993: ANZ Bank Canada amalgamated with Hongkong Bank of Canada — continuing as Hongkong Bank of Canada.

June 30, 1993: FirstLine Trust Company was continued as a federal trust company.

September 24, 1993: Seel Mortgage Investment Corporation ceased to accept deposits — policy cancelled.

November 1, 1993: Landmark Savings and Loan Association ceased to accept deposits — policy cancelled.

November 10, 1993: The Dominion Trust Company was placed in liquidation — policy cancelled.

December 3, 1993: Prenor Trust Company of Canada was placed in liquidation — policy cancelled.

December 6, 1993: Bank Leumi Le-Israel (Canada) amalgamated with Republic National Bank of New York (Canada) — continuing as Republic National Bank of New York (Canada).

December 31, 1993: Morguard Mortgage Investment Company of Canada amalgamated with Metropolitan Trust Company of Canada — continuing as Metropolitan Trust Company of Canada.

January 20, 1994: First Interstate Bank of Canada ceased to accept deposits — policy cancelled.

February 8, 1994: Monarch Trust Company was placed in liquidation — policy cancelled.

March 18, 1994: The Royal Trust Company was continued as a federal trust company.

April 1, 1994: Victoria and Grey Mortgage Corporation amalgamated with The Premier Trust Company — continuing as Victoria and Grey Mortgage Corporation.

May 31, 1994: RBC Trust Company amalgamated with The Royal Trust Company — continuing as The Royal Trust Company.

August 15, 1994: Confederation Trust Company was placed in liquidation — policy cancelled.

August 17, 1994: Montreal Trust Company was continued as a federal trust company.

September 14, 1994: Trustcan Trust Company (formerly General Trust of Canada) ceased to accept deposits — policy cancelled.

October 17, 1994: The International Trust Company ceased operations — policy cancelled.

October 25, 1994: Inland Trust and Savings Corporation Limited ceased to accept deposits — policy cancelled.

December 8, 1994: Overseas Union Bank of Singapore (Canada) ceased to accept deposits — policy cancelled.

December 31, 1994: Canadian Western Bank amalgamated with North West Trust Company — continuing as Canadian Western Bank.

January 1, 1995: Republic National Bank of New York (Canada) amalgamated with Bank Hapoalim (Canada) — continuing as Republic National Bank of New York (Canada).

March 1, 1995: Income Trust Company's policy was terminated. A winding-up order was issued by the Ontario Court of Justice (General Division) on March 6, 1995.

March 31, 1995: Evangeline Trust Company amalgamated with Evangeline Savings and Mortgage Company — continuing as Evangeline Trust Company.

April 6, 1995: U.S. Bank (Canada) ceased to accept deposits — policy cancelled.

July 24, 1995: Bank of Boston Canada ceased to accept deposits — policy cancelled.

October 25, 1995: Banca Nazionale del Lavoro of Canada amalgamated with First Canadian Loan Corporation and continued as First Canadian Loan Corporation. The assets of the continuing company were transferred to, and its liabilities were assumed by, Bank of Montreal.

November 1, 1995: Standard Chartered Bank of Canada amalgamated with TD Loan Corporation, which in turn amalgamated with The Toronto Dominion Bank — continuing as The Toronto-Dominion Bank.

February 13, 1996: Settlers Savings and Mortgage Corporation ceased to accept deposits — policy cancelled.

April 1, 1996: Mitsubishi Bank of Canada amalgamated with The Bank of Tokyo Canada — continuing as Bank of Tokyo-Mitsubishi (Canada).

May 22, 1996: North American Trust Company ceased to accept deposits — policy cancelled.

June 4, 1996: Security Home Mortgage Corporation's policy was terminated. A winding-up order was issued by the Alberta Court of Queen's Bench on December 4, 1996.

August 31, 1996: Barclays Bank of Canada amalgamated with Hongkong Bank of Canada — continuing as Hongkong Bank of Canada.

October 30, 1996: Canadian Western Trust Company was continued as a federal trust company.

October 31, 1996: Family Trust Corporation ceased to accept deposits — policy cancelled.

November 1, 1996: Chemical Bank of Canada amalgamated with The Chase Manhattan Bank of Canada — continuing as The Chase Manhattan Bank of Canada.

November 1, 1996: BLC Mortgage Corporation ceased to accept deposits — policy cancelled.

December 30, 1996: Savings and Investment Trust amalgamated with Laurentian Trust of Canada Inc. — continuing as Laurentian Trust of Canada Inc.

December 31, 1996: The Municipal Trust Company and The Municipal Savings & Loan Corporation ceased to accept deposits — policies cancelled.

January 1, 1997: Israel Discount Bank of Canada amalgamated with Republic National Bank of New York (Canada) — continuing as Republic National Bank of New York (Canada).

January 20, 1997: Citizens Trust Company was continued as a Schedule II bank under the name Citizens Bank of Canada.

February 28, 1997: Daiwa Bank Canada ceased to accept deposits — policy cancelled.

1.3 *Regional Location of CDIC Members**

March 31, 1997	Western	Ontario	Quebec	Eastern	Total
Domestic banks and subsidiaries	3	17	6	—	**26**
Foreign bank subsidiaries	4	35	5	—	**44**
Trust and loan, and subsidiaries	5	17	—	2	**24**
Life insurance subsidiaries	—	5	1	—	**6**
Caisses populaires and credit union affiliates	3	2	4	1	**10**
Total	**15**	**76**	**16**	**3**	**110**

** Based upon the location of the Chief Executive Officer*

2.0 Summary Financial Information — Total CDIC Membership

2.1 *Balance Sheet ($ billions and percentage)*

As at members' fiscal year end	1996 $	1996 %	1995 $	1995 %	1994 $	1994 %	1993 $	1993 %	1992 $	1992 %
Assets										
Cash resources	89.0	8	88.3	9	67.7	8	51.2	6	52.4	7
Securities	204.4	19	181.6	19	157.7	18	140.0	17	114.2	15
Loans	709.7	65	626.5	64	590.4	67	549.6	69	529.6	71
Other assets	83.2	8	73.2	8	63.5	7	62.7	8	54.8	7
Total assets	**1,086.3**	**100**	**969.6**	**100**	**879.3**	**100**	**803.5**	**100**	**751.0**	**100**
Liabilities										
Deposits	783.3	72	742.4	77	686.6	78	639.5	80	618.2	82
Other liabilities	252.1	23	178.9	18	147.7	17	121.5	15	93.1	13
Total liabilities	**1,035.4**	**95**	**921.3**	**95**	**834.3**	**95**	**761.0**	**95**	**711.3**	**95**
Shareholders' equity	50.9	5	48.3	5	45.0	5	42.5	5	39.7	5
Total liabilities and shareholders' equity	**1,086.3**	**100**	**969.6**	**100**	**879.3**	**100**	**803.5**	**100**	**751.0**	**100**

2.2 Income Statement *($ millions)*

For the members' fiscal year	1996	1995	1994	1993	1992
Interest income	68,427	66,505	52,974	51,226	56,320
Interest expense	44,336	44,330	31,556	31,222	36,991
Net interest income	*24,091*	*22,175*	*21,418*	*20,004*	*19,329*
Provision for impairment	2,338	2,981	4,108	5,815	7,762
Net interest income after provision for impairment	*21,753*	*19,194*	*17,310*	*14,189*	*11,567*
Other income	14,154	11,875	11,573	9,944	9,297
Net interest income and other income	*35,907*	*31,069*	*28,883*	*24,133*	*20,864*
Non-interest expenses	24,530	21,940	21,278	19,550	18,548
Net income before provision for income taxes	*11,377*	*9,129*	*7,605*	*4,583*	*2,316*
Provision for income taxes	4,297	3,298	2,920	1,659	649
Net income before non-controlling interest	*7,080*	*5,831*	*4,685*	*2,924*	*1,667*
Non-controlling interest in net income of subsidiaries	124	78	115	75	60
Net income	**6,956**	**5,753**	**4,570**	**2,849**	**1,607**

3.0 Asset Size and Quality Measures — Member Peer Groups

3.1 Total Assets *($ billions and percentage)*

	1996		1995		1994		1993		1992	
	$	%	$	%	$	%	$	%	$	%
Domestic banks and subsidiaries	924.7	85.1	821.2	84.7	741.4	84.3	670.2	83.4	622.7	82.9
Foreign bank subsidiaries	77.0	7.1	65.6	6.8	58.5	6.7	55.8	6.9	52.8	7.0
Trust and loan, and subsidiaries	64.6	5.9	62.3	6.4	60.9	6.9	58.4	7.3	58.0	7.7
Life insurance subsidiaries	3.9	0.4	3.8	0.4	3.9	0.4	5.3	0.7	5.0	0.7
Caisses populaires and credit union affiliates	16.1	1.5	16.7	1.7	14.6	1.7	13.8	1.7	12.5	1.7
Total	**1,086.3**	**100.0**	**969.6**	**100.0**	**879.3**	**100.0**	**803.5**	**100.0**	**751.0**	**100.0**

3.2 Impaired Loans to Total Assets *(percentage)*

	1996	1995	1994	1993	1992
Domestic banks and subsidiaries	1.0	1.6	2.2	3.7	4.1
Foreign bank subsidiaries	1.8	2.7	4.4	5.3	5.4
Trust and loan, and subsidiaries	0.9	0.9	1.1	1.4	1.8
Life insurance subsidiaries	2.2	2.9	4.6	5.5	4.0
Caisses populaires and credit union affiliates	1.5	1.4	1.9	2.5	3.0

Impaired loans (gross) / total assets (gross)

3.3 Impaired Loans to Total Loans *(percentage)*

	1996	1995	1994	1993	1992
Domestic banks and subsidiaries	1.5	2.6	3.3	5.4	5.7
Foreign bank subsidiaries	3.1	4.4	7.2	8.8	8.9
Trust and loan, and subsidiaries	1.1	1.2	1.5	1.8	2.3
Life insurance subsidiaries	3.3	3.7	5.4	6.6	4.9
Caisses populaires and credit union affiliates	1.9	1.9	2.3	3.1	3.7

Impaired loans (gross) / total loans (gross)

3.4 Impaired Loans Unprovided For *(percentage)*

	1996	1995	1994	1993	1992
Domestic banks and subsidiaries	25.0	42.6	47.7	49.3	54.0
Foreign bank subsidiaries	31.6	36.5	44.8	52.4	57.3
Trust and loan, and subsidiaries	22.0	38.9	41.8	51.7	64.9
Life insurance subsidiaries	31.3	13.5	48.1	51.6	57.6
Caisses populaires and credit union affiliates	41.9	51.9	57.3	68.4	65.8

1 – (Allowance for loan impairment / Impaired loans (gross))

3.5 Impaired Loans to Shareholders' Equity *(percentage)*

	1996	1995	1994	1993	1992
Domestic banks and subsidiaries	5.6	14.8	21.7	36.9	43.1
Foreign bank subsidiaries	11.3	18.6	35.6	50.5	54.4
Trust and loan, and subsidiaries	4.5	7.6	9.8	14.7	24.5
Life insurance subsidiaries	7.8	4.5	21.8	36.3	36.0
Caisses populaires and credit union affiliates	14.1	18.9	24.9	37.6	43.3

Impaired loans (net) / average shareholders' equity

4.0 Deposit Liabilities

4.1 Total Deposits *($ billions and percentage)*

As at April 30	1996 $	1996 %	1995 $	1995 %	1994 $	1994 %	1993 $	1993 %	1992 $	1992 %
Domestic banks and subsidiaries	589.2	82.5	555.7	82.3	520.8	82.1	492.1	81.5	453.5	81.8
Foreign bank subsidiaries	52.6	7.4	48.1	7.1	45.1	7.1	41.7	6.9	38.5	6.9
Trust and loan, and subsidiaries	56.7	7.9	56.8	8.4	53.6	8.4	54.1	9.0	52.9	9.5
Life insurance subsidiaries	3.1	0.4	3.4	0.5	4.4	0.7	5.2	0.9	4.1	0.7
Caisses populaires and credit union affiliates	12.8	1.8	11.5	1.7	11.0	1.7	10.4	1.7	6.1	1.1
Total	**714.4**	**100.0**	**675.5**	**100.0**	**634.9**	**100.0**	**603.5**	**100.0**	**555.1**	**100.0**

4.2 Insured Deposits to Total Deposits *(percentage)*

As at April 30	1996	1995	1994	1993	1992
Domestic banks and subsidiaries	43.6	45.1	45.0	46.5	47.0
Foreign bank subsidiaries	15.2	16.0	15.5	16.4	16.1
Trust and loan, and subsidiaries	84.1	84.9	84.3	83.1	82.6
Life insurance subsidiaries	93.6	92.5	93.1	93.9	94.3
Caisses populaires and credit union affiliates	86.4	82.9	83.0	87.6	78.6

5.0 Capitalization Measures

5.1 Capitalization *(percentage)*

	1996	1995	1994	1993	1992
Domestic banks and subsidiaries	4.8	5.0	5.2	5.3	5.4
Foreign bank subsidiaries	5.5	5.7	5.8	5.8	6.0
Trust and loan, and subsidiaries	4.6	4.9	4.9	4.9	4.9
Life insurance subsidiaries	9.1	8.9	8.8	8.3	6.9
Caisses populaires and credit union affiliates	4.5	4.3	4.4	4.7	4.8

Average shareholders' equity / average assets

5.2 BIS Risk-Based Capital *(percentage)**

	1996	1995	1994	1993	1992
Domestic banks and subsidiaries	9.1	9.8	9.8	9.8	9.0
Foreign bank subsidiaries	10.5	10.2	10.5	10.3	9.9
Federal trust and loan, and subsidiaries	11.9	12.3	11.6	10.8	N/A

** BIS (Bank for International Settlements): The minimum requirement is 8.00%. Federal trust and loan companies have been required to meet the 8.00% since 1993. Provincial trust and loan companies have to meet capital adequacy requirements that are calculated under a different basis.*

6.0 Income and Profitability Measures

6.1 Net Income ($ millions)

	1996	1995	1994	1993	1992
Domestic banks and subsidiaries	6,278	5,191	4,276	2,866	1,710
Foreign bank subsidiaries	289	239	113	-148	-287
Trust and loan, and subsidiaries	305	288	253	179	223
Life insurance subsidiaries	16	-15	-42	-66	-68
Caisses populaires and credit union affiliates	68	50	-30	18	29
Total	**6,956**	**5,753**	**4,570**	**2,849**	**1,607**

6.2 Interest Spread (percentage)

	1996	1995	1994	1993	1992
Domestic banks and subsidiaries	2.4	2.5	2.7	2.7	2.8
Foreign bank subsidiaries	1.9	1.9	1.6	1.4	1.5
Trust and loan, and subsidiaries	2.4	2.2	2.2	2.1	2.2
Life insurance subsidiaries	2.0	1.7	1.3	0.9	0.7
Caisses populaires and credit union affiliates	2.2	2.1	2.4	2.5	2.6

Interest spread: (interest income – interest expense)/average assets

6.3 Other Income (percentage)

	1996	1995	1994	1993	1992
Domestic banks and subsidiaries	1.4	1.3	1.4	1.3	1.3
Foreign bank subsidiaries	1.2	1.2	1.6	1.5	1.4
Trust and loan, and subsidiaries	1.2	1.0	0.8	0.7	0.7
Life insurance subsidiaries	1.0	1.3	0.7	0.7	0.4
Caisses populaires and credit union affiliates	1.2	0.9	0.9	0.8	0.9

Other income: other income/average assets

6.4 Non-Interest Expenses (percentage)

	1996	1995	1994	1993	1992
Domestic banks and subsidiaries	3.1	3.1	3.5	3.6	3.9
Foreign bank subsidiaries	2.6	2.7	3.0	3.2	3.5
Trust and loan, and subsidiaries	3.1	2.8	2.6	2.6	2.6
Life insurance subsidiaries	2.5	3.3	3.2	2.9	2.6
Caisses populaires and credit union affiliates	3.0	2.7	3.5	3.1	3.3

Non-interest expenses: (non-interest expenses + provision for income taxes + minority interest in subsidiaries + provision for impairment)/average assets

6.5 Return on Average Assets (percentage)

	1996	1995	1994	1993	1992
Domestic banks and subsidiaries	0.7	0.7	0.6	0.4	0.3
Foreign bank subsidiaries	0.4	0.4	0.2	-0.3	-0.6
Trust and loan, and subsidiaries	0.5	0.5	0.4	0.3	0.4
Life insurance subsidiaries	0.4	-0.4	-0.9	-1.3	-1.4
Caisses populaires and credit union affiliates	0.4	0.3	-0.2	0.1	0.2

ROAA: net income / average assets

6.6 Return on Average Equity *(percentage)*

	1996	1995	1994	1993	1992
Domestic banks and subsidiaries	15.1	13.3	11.7	8.4	5.3
Foreign bank subsidiaries	7.4	6.7	3.4	-4.7	-9.4
Trust and loan, and subsidiaries	10.4	9.6	8.6	6.3	8.0
Life insurance subsidiaries	4.4	-4.2	-10.4	-15.5	-20.7
Caisses populaires and credit union affiliates	9.3	7.5	-4.8	3.0	5.2

ROAE: net income / average shareholders' equity

6.7 Productivity *(percentage)*

	1996	1995	1994	1993	1992
Domestic banks and subsidiaries	63.3	63.4	63.4	63.9	63.9
Foreign bank subsidiaries	68.8	69.4	66.9	74.2	70.3
Trust and loan, and subsidiaries	69.8	72.7	75.6	73.5	72.2
Life insurance subsidiaries	76.1	71.0	109.3	142.4	163.2
Caisses populaires and credit union affiliates	76.0	78.4	81.5	76.6	74.4

Productivity: non-interest expenses/(net interest income + other income)

7.0 CDIC Premiums *($ millions and percentage)**

As at April 30	1996 $	1996 %	1995 $	1995 %	1994 $	1994 %	1993 $	1993 %	1992 $	1992 %
Domestic banks and subsidiaries	428.2	78.3	418.0	77.6	390.5	76.6	286.4	75.4	218.8	72.2
Foreign bank subsidiaries	13.4	2.4	13.0	2.4	12.2	2.4	9.0	2.4	6.6	2.2
Trust and loan, and subsidiaries	81.0	14.8	82.2	15.3	79.0	15.5	61.8	16.3	61.0	20.2
Life insurance subsidiaries	5.3	1.0	5.6	1.0	8.3	1.6	7.5	2.0	5.9	2.0
Caisses populaires and credit union affiliates	18.9	3.5	20.0	3.7	19.7	3.9	14.6	3.9	10.4	3.4
Total	**546.8**	**100.0**	**538.8**	**100.0**	**509.7**	**100.0**	**379.3**	**100.0**	**302.7**	**100.0**

* *The premiums reflect amended Return of Insured Deposits filings and therefore do not necessarily agree with CDIC's premium income for accounting purposes.*

FINANCIAL OVERVIEW — 1996/97

HIGHLIGHTS

During 1996/97, CDIC's deficit decreased by $125 million to $1.176 billion. Loans from the Consolidated Revenue Fund (CRF) decreased by $772 million, from $1.6 billion to $865 million. As at March 31, 1997, the loans from the CRF were as planned, whereas the deficit was $131 million higher than forecast in the 1997/98-2001/02 *Corporate Plan*. The higher deficit is a result of a change in accounting estimate as explained below.

During the year, the Corporation enhanced its methodology for estimating the amount of the provision for insurance losses, by providing for the risk of loss relating to insured deposits by using a market-based composite weighting system. The resulting change in accounting estimate increased the provision for insurance losses to $500 million as at March 31, 1997, from $150 million at March 31, 1996.

The net recoveries of loans and claims receivable in 1996/97 totalled $247 million. These recoveries are net of the payment of $42 million made to the insured depositors of Security Home Mortgage Corporation (SHMC), which was liquidated during the year.

The provision for guarantees decreased by $45 million to $646 million at March 31, 1997.

The premium rate for deposit insurance was maintained at one-sixth of one percent. This rate, combined with a growth of 1.5 percent in the level of insured deposits, generated $546 million in premium revenue.

A five-year financial and statistical summary can be found on page 53 of this report.

Change in Accounting Estimate

As explained more fully in note 3 to the financial statements, the Corporation changed its methodology for estimating the amount of the provision for insurance losses. In prior years, the methodology provided almost entirely for institutions on CDIC's watch list. As part of the continuing process of enhancing the accounting for insurance losses that the Corporation will incur, the methodology was augmented to include a market-based composite risk-weighting system, mainly for institutions not on CDIC's watch list. Although the net increase to the provision for insurance losses is $350 million, the increase resulting from the market-based system resulted in an increase in estimate of $450 million, offset by a $100 million reduction in respect of watch list institutions.

New Accounting Standards

Two new accounting standards, Financial Instruments and Measurement Uncertainty, promulgated by the Canadian Institute of Chartered Accountants (CICA) have resulted in additional disclosure in the notes to the 1996/97 financial statements.

Financial Instruments — CICA Handbook (s. 3860)

To comply with the requirements of the Financial Instruments section, CDIC significantly increased the extent of disclosure in the notes to the financial statements pertaining to its financial assets and liabilities. The following are the most significant financial assets and liabilities of CDIC:

- cash and short-term investments;
- loans and claims receivable;

- provision for guarantees;
- provision for insurance losses; and
- loans from the Consolidated Revenue Fund.

Extensive disclosure about the terms and conditions, the fair value and the risks associated with these assets and liabilities is provided in note 9 — Financial Instruments. Many of the other notes to the financial statements have been expanded to provide additional disclosure about these financial assets and liabilities.

Measurement Uncertainty — CICA Handbook (s. 1508)

The section on Measurement Uncertainty requires additional disclosure about the nature and extent of the uncertainty involved in estimates and assumptions that affect the amounts reported in the financial statements. The following items are subject to measurement uncertainty in CDIC's financial statements:

- the allowance for loss on loans and claims receivable;
- the provision for guarantees; and
- the provision for insurance losses.

Additional disclosure about measurement uncertainty involved in estimating amounts for the above items is provided mainly in note 2 — Significant Accounting Policies, under the caption "Use of Estimates."

Loans and Claims Receivable

Loans and claims receivable as at March 31, 1997, totalled $693 million (net of an allowance for loss of $74.5 million). As at March 31, 1996, loans and claims receivable totalled $902.5 million (net of an allowance for loss of $143.5 million). The decrease in the net receivable amount of loans and claims receivable is due to a combination of factors, including recoveries of $247 million (net of $42 million in claims paid to SHMC depositors) and write-offs of $31.4 million, offset by a decrease in the allowance for loss on loans and claims receivable of $37.6 million.

Provision for Guarantees

The provision for guarantees as at March 31, 1997, was $646 million — down from $691 million as at March 31, 1996. As mentioned in note 6 to the financial statements, all outstanding guarantees will expire, on a diminishing basis, by the year 2002.

Interest Costs

Interest costs for the year amounted to $85 million (1995/96: $122 million). The substantial reduction in interest costs reflects the decreasing amount of outstanding loans from the CRF. As discussed in the Corporate Management section of this report, the CDIC Act has been amended to allow CDIC to borrow from sources other than the Crown. CDIC will be required to pay a fee on all new borrowings and on existing borrowing outstanding as at April 1, 1999. The application of this fee will result in an increase to the cost of funds of CDIC. As at March 31, 1997, CDIC's weighted-average cost of funds was 6.5 percent.

Operating and Intervention Expenses

The operating expenses for 1996/97 amounted to $13.9 million (1995/96: $14.0 million). Intervention expenses for 1996/97 were $3.4 million (1995/96: $3.6 million). In both cases, actual spending compares favourably with the approved budgets of $14.1 million for operating expenses and $4.5 million for intervention expenses.

Five-Year Financial and Statistical Summary

	12 Months Ended March 31, 1997	12 Months Ended March 31, 1996	12 Months Ended March 31, 1995	15 Months Ended March 31, 1994	12 Months Ended Dec. 31, 1992
		($ millions unless otherwise indicated)			
Insurance Program					
Accumulated deficit	(1,176)	(1,301)	(1,747)	(1,648)	(1,451)
Total insured deposits ($ billions)	328	323	308	303	302
Premiums assessed	546	538	513	391	302
Assets and Liabilities					
Claims paid	42	—	873	1,351	493
Claims recovered	181	644	1,025	1,048	263
Loans disbursed	73	49	2	157	1,539
Loans recovered	181	104	651	618	19
Additional loans (repayments) from the CRF	(772)	(533)	(991)	(499)	1,835
Payment of guarantees	67	342	104	65	—
Operations					
Operating expenses	14	14	14	17(1)	17
Intervention expenses	3	4	5	9(1)	12
Interest expense on CRF loans	85	122	182	270(1)	177
Provision for loss	334	(30)	430	108(2)	960
Member Institutions					
Number of federal institutions — banks	52	55	59	61	61
Number of federal institutions — trust and loan companies	44	43	42	47	51
Number of provincial institutions	14	20	20	23	30
Total number of institutions	110	118	121	131	142
Number of insolvencies	1	1	2	3	5
Employees					
Number of permanent employees[3]	77	86	87	90	94
Other					
Average cost of funds	6.5%	6.5%	6.5%	6.3%	7.2%
Growth rate of insured deposits	1.5%	5.1%	1.7%	0.2%	3.8%
Insured deposits as a percentage of total deposit liabilities	45.7%	47.2%	47.6%	49.1%	50.8%

(1) The figures provided in the schedule are for a 15-month period. Comparative numbers for the 12 months ending March 31, 1994, are as follows:

Operating expenses	*$ 14*
Intervention expenses	*$ 7*
Interest expense on CRF loans	*$ 209*

(2) In addition to this provision of $108 million, the Corporation that year took a one-time retroactive provision of $200 million in respect of the change in accounting policy for the general provision for loss.

(3) Represents the number of full-time, permanent employees at period end. Vacant approved positions have not been included.

Management Responsibility for Financial Statements

May 2, 1997

The accompanying financial statements of the Canada Deposit Insurance Corporation and the information related to the financial statements in this *Annual Report* are the responsibility of management. The financial statements have been prepared in accordance with generally accepted accounting principles, and particular consideration was given to the new CICA Accounting Recommendations pertaining to Financial Instruments and Measurement Uncertainty. The financial statements include some amounts, the most significant ones being the loans and claims receivable, the provision for guarantees and the provision for insurance losses, that are necessarily based on management's best estimates and judgement.

The financial statements have been approved by the Board of Directors. Financial information presented elsewhere in the *Annual Report* is consistent with that contained in the financial statements.

In discharging its responsibility for the integrity and fairness of the financial statements, management maintains financial and management control systems and practices designed to provide reasonable assurance that transactions are duly authorized, assets are safeguarded and proper records are maintained in accordance with the *Financial Administration Act* and regulations as well as the *Canada Deposit Insurance Corporation Act* and by-laws of the Corporation. The system of internal control is augmented by internal audit, which conducts periodic reviews of different areas of the Corporation's operations. In addition, the internal and external auditors have free access to the audit committee of the Board, which oversees management's responsibilities for maintaining adequate control systems and the quality of financial reporting and which recommends the financial statements to the Board of Directors.

These financial statements have been audited by the Corporation's auditor, the Auditor General of Canada, and his report is included herein.

Jean Pierre Sabourin
President and Chief Executive Officer

Johanne R. Lanthier
Vice-President, Finance

AUDITOR GENERAL OF CANADA

VÉRIFICATEUR GÉNÉRAL DU CANADA

AUDITOR'S REPORT

To the Minister of Finance

I have audited the balance sheet of the Canada Deposit Insurance Corporation as at March 31, 1997 and the statements of income and deficit and changes in financial position for the year then ended. These financial statements are the responsibility of the Corporation's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Corporation as at March 31, 1997 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles. As required by the Financial Administration Act, I report that, in my opinion, these principles have been applied on a basis consistent with that of the preceding year.

Further, in my opinion, the transactions of the Corporation that have come to my notice during my audit of the financial statements have, in all significant respects, been in accordance with Part X of the Financial Administration Act and regulations, the Canada Deposit Insurance Corporation Act and the by-laws of the Corporation.

John Wiersema, CA
Assistant Auditor General
for the Auditor General of Canada

Ottawa, Canada
May 2, 1997

Balance Sheet as at March 31
(in thousands of dollars)

	Note	1997	1996
Assets			
Cash and short-term investments	4	$ 148,716	$ 292,985
Premiums and other accounts receivable		3,996	11,700
Capital assets		1,569	1,655
		154,281	306,340
Loans and claims receivable	5, 7	693,123	902,524
		$ 847,404	$ 1,208,864

	Note	1997	1996
Liabilities			
Accounts payable		$ 12,596	$ 28,425
Provision for guarantees	6, 7	645,941	691,271
Provision for insurance losses	3, 7	500,000	150,000
Loans from the Consolidated Revenue Fund	8	865,047	1,640,141
		2,023,584	2,509,837
Deficit, end of year		(1,176,180)	(1,300,973)
		$ 847,404	$ 1,208,864

Approved by the Board:

Director

Director

Statement of Income and Deficit for the year ended March 31

(in thousands of dollars)

	Note	1997	1996
Revenue			
Premiums		$ 546,293	$ 537,742
Interest on cash and short-term investments		10,433	9,134
Other revenue		4,192	5,677
		560,918	552,553
Expenses			
Interest on loans from the Consolidated Revenue Fund		84,835	121,917
Adjustment to provisions for loss	3, 7	333,713	(29,603)
Recovery of amounts previously written off		—	(3,910)
Operating expenses		13,881	13,961
Intervention expenses		3,402	3,573
Other interest		294	452
		436,125	106,390
Net income		124,793	446,163
Deficit, beginning of year		(1,300,973)	(1,747,136)
Deficit, end of year		$ (1,176,180)	$ (1,300,973)

Statement of Changes in Financial Position for the year ended March 31

(in thousands of dollars)

	1997	1996
Operating Activities		
Net income	$ 124,793	$ 446,163
Non-cash items included in net income		
Adjustment to provisions for loss	333,713	(29,603)
Other	590	579
Net purchase of capital assets	(504)	(420)
Payment of guarantees	(66,680)	(341,940)
Loans disbursed	(73,238)	(48,638)
Loans recovered	180,946	103,648
Claims paid	(42,133)	—
Claims recovered	181,462	643,974
Decrease in working capital	(11,218)	(3,592)
Cash provided by operating activities	627,731	770,171
Financing Activities		
Loans from the Consolidated Revenue Fund		
Advances	100,000	250,000
Repayments	(872,000)	(783,000)
Cash used in financing activities	(772,000)	(533,000)
Cash and Short-Term Investments		
(Decrease) increase during the year	(144,269)	237,171
Balance, beginning of year	292,985	55,814
Balance, end of year	$ 148,716	$ 292,985

NOTES TO FINANCIAL STATEMENTS

MARCH 31, 1997

1. Authority and Objective

The Corporation was established in 1967 by the *Canada Deposit Insurance Corporation Act* (the CDIC Act). It is a Crown corporation named in Part I of Schedule III to the *Financial Administration Act*.

The objects of the Corporation are to provide insurance against the loss of part or all of deposits in member institutions, to be instrumental in the promotion of standards of sound business and financial practices for member institutions, and to promote and otherwise contribute to the stability of the financial system in Canada. These objects are to be pursued for the benefit of depositors of member institutions and in such manner as will minimize the exposure of the Corporation to loss.

The Corporation has the power to do all things necessary or incidental to the furtherance of its objects, including acquiring assets from, and providing guarantees or loans to, member institutions. Among other things, it may make or cause to be made inspections of member institutions, make standards of sound business and financial practices, and act as liquidator, receiver or inspector of a member institution or a subsidiary thereof.

2. Significant Accounting Policies

Basis of Preparation

These financial statements have been prepared in accordance with generally accepted accounting principles. These financial statements do not reflect the assets, liabilities or operations of failed member institutions in which the Corporation has intervened.

Use of Estimates

The Corporation's financial statements are prepared in accordance with generally accepted accounting principles and necessarily include estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. The more significant areas requiring the use of estimates are: i) the allowance for loss on loans and claims receivable, ii) the provision for guarantees, and iii) the provision for insurance losses.

The Corporation reviews these estimates annually. Actual losses, in the near term, could differ significantly from those estimates depending upon certain events and uncertainties including:

- The ability of the Corporation to recover its claims and loans receivable based on prevailing economic trends and expectations as to future developments.
- The Corporation's ability to recover its claims and loans receivable either by maximizing net recoveries from the sale of assets held by liquidators and agents, or through successful lawsuits as appropriate against relevant parties of failed member institutions.
- The extent to which the Corporation will be called upon to honour guarantees provided to member institutions and others.

- The timing and extent of losses the Corporation will incur as a result of future failures of member institutions. The provision for insurance losses is determined by assessing a wide variety of possible outcomes. As such, the provision is based on historical experience, on market perceptions, on legal and regulatory developments, on prevailing economic trends and on expectations as to future developments, and accordingly involves considerable judgement.

The risk of deviation from the Corporation's estimates varies in proportion to the length of the estimation period and the potential volatility of the underlying assumptions. In the event that ultimate losses do vary from the current estimates, the Corporation could recommend to the Governor in Council that the annual premium charged to member institutions be increased or decreased, depending on the situation. Also, the Corporation has the authority to borrow up to $6 billion from the capital markets and from the Consolidated Revenue Fund to finance its needs as appropriate.

Short-Term Investments

The Corporation maintains sufficient liquidity in its investment portfolio to meet general operating requirements as well as borrowing obligations. These investments, consisting of marketable securities and term deposits, are carried at cost as they are intended to be held to maturity.

Loans Receivable

The Corporation may make loans to member institutions and others. The main purpose of providing these loans is to facilitate a resolution of the financial difficulties of member institutions. The terms and conditions of these loans provide for repayment of principal and, as recovery of the cost of providing loans, the Corporation charges interest. To the extent interest revenue is recorded in the accounts, it is included in other revenue.

Claims Receivable

Claims against member institutions arise from the subrogation of the rights and interests of depositors to the extent of the amount of the payment made by the Corporation to insured depositors. In addition, the Corporation asserts claims in respect of loans made to member institutions in liquidation. The Corporation does not accrue and/or record any interest revenue on its claims receivable.

Allowance and Provisions for Loss

In its financial statements, the Corporation records the following allowance and provisions for loss:

- *Allowance for Loss on Loans and Claims Receivable* — The allowance for loss on loans and claims receivable reflects the Corporation's best estimate of losses in respect of loans and claims receivable. The allowance is established by assessing the anticipated results of the asset disposition strategies and forecasted payments to creditors based on information received from the liquidators of failed member institutions and from other parties acting on behalf of the Corporation.

  Loans and claims receivable are written off against the allowance, in full or in part, when there is reasonable doubt as to realization. When the Corporation recovers amounts previously written off, these are recorded as a recovery of amounts previously written off.

- *Provision for Guarantees* — In order to facilitate the resolution of financial difficulties of member institutions, the Corporation may provide guarantees. The provision for guarantees is determined by estimating the future cash payments required under these guarantees.

- *Provision for Insurance Losses* — The provision for insurance losses represents the Corporation's best estimate of future losses it will incur as a result of insuring deposits of member institutions.

  The provision is established by: (i) assessing the aggregate risk of member institutions based on the Corporation's specific knowledge of its members, (ii) providing for the risk of loss relating to insured deposits by using a market-based composite risk-weighting system, and (iii) applying the present value of loss experience in past member institution failures during the preceding seven years.

  The market-based composite risk-weighting system is affected by two factors: (i) the credit ratings of member institutions; and (ii) the market spreads between corporate bond issues and benchmark bond issues of the Government of Canada for comparable terms.

Changes in the various provisions for loss that result from annual estimations for financial reporting purposes are recognized as an adjustment to the provisions for loss in the period in which the changes occur.

Premium Revenue

Premiums are based on the amount of insured deposits held by member institutions as at April 30 of each year. Premiums are recorded annually based on a Return of Insured Deposits from member institutions, which is due July 15 of each year. Premiums are payable in two equal instalments on July 15 and December 15.

Other Revenue

The Corporation charges interest on loans made to member institutions and others. Interest continues to accrue on loans but is not recognized in the accounts when, in the Corporation's opinion, there is reasonable doubt as to collectibility of the interest. In such cases, interest payments received are recognized as a reduction of the loan balance until such time as the loans are retired. Subsequent payments are recognized as other revenue on a cash basis.

In some cases, amounts recovered from the estates of member institutions (claims receivable) exceed the amount claimed. These amounts are also recorded as other revenue on a cash basis.

3. Change in Accounting Estimate

During the year, the Corporation enhanced its methodology for estimating the amount of the provision for insurance losses. This enhancement is part of the continuing process of estimating and accounting for insurance losses that the Corporation will incur.

As a result of this change in methodology, the estimate for the provision for insurance losses has increased to $500 million as at March 31, 1997 from $150 million as at March 31, 1996, as reflected in Note 7. If this methodology had been available to estimate the amount of the provision last year, the provision, at that time, would have been $650 million.

Pursuant to the 1996 amendments to the CDIC Act, the Corporation began developing a Premium By-law which, once passed, will establish a system for differential premiums. Member institutions will be rated by category and each category will have a different premium rate. As a result of developing the differential premium system, the Corporation has better information and analytical tools with which to assess its overall risk of loss resulting from insuring deposits in member institutions. Further enhancements to the methodology for estimating insurance losses will be made once the system for differential premiums is complete.

4. *Cash and Short-Term Investments* *(in thousands of dollars)*

	March 31, 1997	March 31, 1996
Bankers' Acceptances	$ 102,201	$ 126,257
Bearer Deposit Notes	22,197	82,080
Term Deposits	11,118	37,000
Commercial Paper	12,668	9,736
Promissory Notes	—	38,069
	148,184	293,142
Cash	532	(157)
TOTAL	$ 148,716	$ 292,985

The short-term investments have a weighted average effective yield of 3.11% (1996: 5.17%) and have a weighted average term to maturity of 25 days (1996: 32 days).

5. *Loans and Claims Receivable* *(in thousands of dollars)*

	March 31, 1997	March 31, 1996
Loans receivable	$ 433,883	$ 567,091
Allowance for loss	(18,100)	(45,800)
Net loans receivable	415,783	521,291
Claims receivable	333,740	478,933
Allowance for loss	(56,400)	(97,700)
Net claims receivable	277,340	381,233
TOTAL	$ 693,123	$ 902,524

Loans

The loans receivable are repayable on demand and bear interest at floating rates determined in accordance with formulas based either on prime rate or the rate for 90-day Treasury Bills. No interest revenue was recorded on existing loans receivable as the criteria for interest revenue recognition on the loans were not met. No new loans were made during the year.

Claims Receivable

During the year, Security Home Mortgage Corporation was placed in liquidation, and the Corporation paid $42 million to insured depositors.

6. Provision for Guarantees

In the course of business, the Corporation provides various guarantees to member institutions and others.

In order to facilitate the resolution of member institutions in financial difficulty, the Corporation provided deficiency coverage guarantees. These guarantees provide for payment of a portion of the principal and income losses incurred on eligible assets acquired by third parties. The guarantees will remain in force on a diminishing basis until the year 2002.

The Corporation also provided collaterized guarantees to the investors of distress preferred shares issued by Adelaide Capital Corporation, a former member institution. These shares are to be redeemed on or before December 1999, at which time the Corporation may be called upon to honour its guarantees.

The nominal amount of outstanding guarantees provided by the Corporation is $2.4 billion as at March 31, 1997 (1996: $2.9 billion) and the provision for guarantees as at March 31, 1997 is $645.9 million (1996: $691.3 million). The nominal amount represents the maximum exposure of the Corporation with respect to the guarantees provided. The nominal amount is not representative of the amount the Corporation expects to pay to third parties to meet its obligations under these guarantees.

7. Allowance and Provisions for Loss

The following table is a continuity schedule of the allowance for loss on loans and claims receivable, the provision for guarantees and the provision for insurance losses as at March 31, 1997 with corresponding totals as at March 31, 1996.

	March 31, 1997					March 31, 1996
	Loans Receivable	Claims Receivable	Guarantees	Insurance Losses	Total	Total
			(in thousands of dollars)			
Beginning of period	$ 45,800	$ 97,700	$ 691,271	$ 150,000	$ 984,771	$1,658,483
Payments	—	—	(66,680)	—	(66,680)	(341,940)
Write-offs	(30,000)	(1,363)	—	—	(31,363)	(302,169)
Adjustment to provisions for loss	2,300	(39,937)	21,350	(100,000)	(116,287)	(29,603)
Change in accounting estimate	—	—	—	450,000	450,000	
End of period	$ 18,100	$ 56,400	$ 645,941	$ 500,000	$1,220,441	$ 984,771

The allowance and provisions for loss are subject to measurement uncertainty. As such, Actual losses may differ significantly from these estimates.

8. Loans from the Consolidated Revenue Fund

Pursuant to 1996 amendments to the CDIC Act, the Corporation may borrow from sources other than the Consolidated Revenue Fund. The total borrowings of the Corporation may not exceed $6 billion.

As at March 31, 1997, the Corporation has $865 million in outstanding loans from the Consolidated Revenue Fund including accrued interest of $10 million (March 31, 1996: $1,640 million, including accrued interest of $13 million).

The Corporation's risk management policy requires that a minimum of 80% of the debt portfolio be matched to future cash flows as to timing and amount. At March 31, 1997, the portfolio is fully matched. The loans bear interest at various fixed rates ranging from 5.87% to 7.33% (1996 – 5.87% to 7.33%) and the principal is repayable according to the following schedule:

Fiscal Year	Amount *(in millions of dollars)*
1997/98	$ 460
1998/99	395
Accrued interest as at March 31, 1997	10
	$ 865

9. Financial Instruments

Credit Risk

The Corporation is subject to credit risk from its holdings of short-term investments. Credit risk is minimized by investing in high credit-quality financial institutions or in short-term, high quality debt securities, and by limiting the amount invested in any one counterparty.

All of the loans and claims receivable relate to troubled or failed member institutions. The Corporation's credit risk exposure relating to loans receivable is directly impacted by these entities' ability to generate cash flows sufficient to meet their obligations to the Corporation as they become due. Realizations of claims receivable is largely dependent on the credit quality or value of assets held by the failed member institutions. The value of a significant portion of the remaining assets is dependent on real estate markets. As such, the Corporation is exposed to significant concentrations of credit risk arising from the real estate industry.

Fair Value

No active or liquid market exists in which the Corporation's most significant financial assets and liabilities could be traded. Where no market exists for financial instruments, fair value estimates are based on judgements regarding current and future economic conditions and events, the risk characteristics of the instruments, and other factors. The estimates of fair value discussed below are made as at March 31, 1997 and involve uncertainties and matters of significant judgement. Changes in assumptions could materially affect the estimates.

The book value of cash and short-term investments, premiums and other accounts receivable and accounts payable approximate their fair value because of their short term to maturity.

The book value of loans and claims receivable approximates their fair value as it represents the Corporation's best estimate of the amounts to be realized based on asset disposition strategies and forecasted repayments on account of loans and claims receivable. The Corporation's estimates are based on information received from the liquidators of failed member institutions and from other parties acting on behalf of the Corporation.

The fair value of the provision for guarantees is not readily determinable due to the uncertain timing of future payments, but in any case, fair value would be less than book value, which has been determined without reference to discounting for the time value of money.

The book value of the provision for insurance losses approximates its fair value as it represents the Corporation's best estimate of the future claims to be paid to insured depositors and related expenses.

The fair value of the loans from the Consolidated Revenue Fund (Note 8) is $890 million (1996: $1,651 million). The fair value is estimated based on the present value of contractual cash flows discounted at the rate currently available to Crown corporations for debt with similar remaining terms to maturity. No provision has been made for early repayment penalties as the Corporation intends to settle the loans in accordance with their original terms.

10. Income Taxes

The Corporation is subject to federal income tax and has losses that can be carried forward to reduce future years' earnings for tax purposes.

Such losses total $1,105 million and expire as follows:

Year	Amount *(in millions of dollars)*
1998	$ 141.8
1999	224.1
2000	224.6
2001	96.4
2002	202.4
2003	125.5
2004	90.4
	$ 1,105.2

11. Contingent Liabilities

The Corporation is involved in a number of judicial actions arising in the normal course of operations. Although the final outcome with respect to claims and legal proceedings pending at March 31, 1997 cannot be predicted with certainty, in the opinion of the Corporation, none of these, individually or in the aggregate, would result in liability that would have a significant adverse effect on the financial position of the Corporation. Any impact of such matters will be reflected in the period in which the matter becomes determinable.

12. Insured Deposits

Deposits insured by the Corporation, on the basis of returns received from member institutions as described in Note 2, *Premium Revenue*, as at April 30, 1996 and 1995, were as follows:

	1996	**1995**
	(in billions of dollars)	
Federal institutions	$ 314	$ 307
Provincial institutions	14	16
	$ 328	$ 323

In accordance with paragraph 21(1)(b) of the CDIC Act, the premium rate for the premium year 1997 was set at one-sixth of one percent of insured deposits, the same rate as in 1996.

13. Comparative Figures

Certain of the 1996 figures have been reclassified to conform with the presentation adopted for 1997.

CORPORATE GOVERNANCE

The Canada Deposit Insurance Corporation was established in 1967 under the *Canada Deposit Insurance Corporation Act*. The Act sets out CDIC's constitution, objects, powers and duties, the general terms of deposit insurance, and other governing parameters. CDIC functions within the legal framework established by the CDIC Act, the *Financial Administration Act*, and section 18 of the *Office of the Superintendent of Financial Institutions Act*, including the amendments made to these Acts over the years. The Corporation is ultimately accountable, through the Minister of Finance, to Parliament for the conduct of its affairs.

Board of Directors

The CDIC Act states that the Board of Directors "shall administer the affairs of the Corporation in all things...."

The Board is made up of the Chairperson, appointed by the Governor in Council during good behaviour for a five-year term, four *ex officio* directors—the Governor of the Bank of Canada, the Deputy Minister of Finance, the Superintendent of Financial Institutions, and a Deputy Superintendent of Financial Institutions—and four private-sector members, also appointed by the Governor in Council during good behaviour for a three-year term. On March 31, 1997, the composition of the Board was as follows:

Grant L. Reuber(1)(3)
Chairperson of the Board
Canada Deposit Insurance Corporation
(January 8, 1993)*

Viateur Bergeron, Q.C.(2)
Partner
Bergeron, Gaudreau
Hull
(August 7, 1996)*

David A. Dodge
Deputy Minister of Finance
(ex officio)

H. Garfield Emerson, Q.C.(2)
President and Chief Executive Officer
Rothschild Canada Ltd.
Toronto
(December 20, 1994)*

Bernard I. Ghert(1)
President
Ghert Realty Holdings Ltd.
Toronto
(June 9, 1993)*

Colin P. MacDonald(3)
Partner
Howard, Mackie
Calgary
(December 20, 1994)*

John R. V. Palmer(1)(2)
Superintendent of Financial Institutions
(ex officio)

Gordon G. Thiessen
Governor of the Bank of Canada
(ex officio)

John Thompson(3)
Deputy Superintendent, Operations
Office of the Superintendent of Financial Institutions
(ex officio)

(1) *Member of the Executive Committee*
(2) *Member of the Audit Committee*
(3) *Member of the Employee Relations Committee*

* *Date of Governor-in-Council appointment*

Officers and Operations

The officers include the Chairperson, the President and Chief Executive Officer, who are both appointed by the Governor in Council, at pleasure, for a five-year term, and officers appointed by the Board of Directors under By-law No. 2, made under the Act.

All officers are members of the ***Executive Management Committee***, which is chaired by the President and Chief Executive Officer. This committee also includes the directors of Corporate Affairs, Audit and Consulting Services, and Human Resources. Except for the Chairperson and the Director, Human Resources, all members of the committee report directly to the President and CEO, who reports to the Board through the Chairperson. The Corporate Secretary and General Counsel has a dual reporting relationship: to the Chairperson as Corporate Secretary and to the President and CEO as General Counsel and head of the Legal Division.

The officers individually and collectively through the committee are responsible for the management and day-to-day operations of the Corporation. On March 31, 1997, the officers of the Corporation were as follows:

Grant L. Reuber
Chairperson of the Board
(January 8, 1993)*

Jean Pierre Sabourin
President and Chief
Executive Officer
(June 1, 1996)*

Guy L. Saint-Pierre
Senior Vice-President
Insurance and Risk Assessment

Wayne Acton
Senior Vice-President
Field Operations

Johanne R. Lanthier
Vice-President
Finance

Lewis T. Lederman, Q.C.
Corporate Secretary and
General Counsel

Bert Scheepers
Vice-President
Corporate Services

* *Date of Governor-in-Council appointment*

Inter-Agency Committees

The Chairperson of CDIC is a statutory member of the ***Financial Institutions Supervisory Committee*** (FISC) and a member of the ***Senior Advisory Committee*** (SAC) of the Department of Finance. The other members of these committees are the Governor of the Bank of Canada, the Deputy Minister of Finance, who is the Chairman of SAC, and the Superintendent of Financial Institutions, who chairs FISC.

The purpose of FISC is to facilitate consultations and the exchange of information among its members on all matters relating directly to the supervision of financial institutions. The role of SAC is to provide a forum for the review of policies related to financial markets and the financial services sector.

The ***OSFI/CDIC Liaison Committee*** is jointly chaired by the Superintendent of Financial Institutions and the Chairperson of CDIC. This committee's purpose is to co-ordinate closely the activities of OSFI and CDIC, to avoid unwarranted duplication and cost, and generally to foster close and effective working relationships between the two agencies. On March 31, 1997, the members were as follows:

Co-Chair
John R. V. Palmer
Superintendent of Financial Institutions
OSFI

Co-Chair
Grant L. Reuber
Chairperson of the Board
CDIC

Members

Jack W. Heyes
Director General,
Deposit-Taking Institutions
OSFI

Ken Mylrea
Director General, Insurance
CDIC

Kim Norris
Director, Financial Analysis Division
OSFI

Jean Pierre Sabourin
President and Chief Executive Officer
CDIC

Guy L. Saint-Pierre
Senior Vice-President,
Insurance and Risk Assessment
CDIC

John Thompson
Deputy Superintendent,
Operations
OSFI

The ***Joint OSFI/CDIC Information Systems Steering Committee*** is responsible for reviewing and developing opportunities for shared systems initiatives. The members of the committee, as at March 31, 1997, were as follows:

Chair
Cynthia Louch
Director, Information Systems
CDIC

Adviser
George Hopkins
Executive Vice-President
Bank of Montreal

Members
Gerry Champagne
Director, Information and
Business Services
OSFI

Ken Mylrea
Director General, Insurance
CDIC

Kim Norris
Director, Financial Analysis
Division
OSFI

The ***FISC Data Processing Project Steering Committee*** is responsible for overseeing the development of the Tri-Agency Database System. This system is being developed concertedly by the Bank of Canada, OSFI and CDIC. On March 31, 1997, the committee was made up of the following members:

Chair
Kim Norris
Director, Financial Analysis
Division
OSFI

Members
J. P. Aubry
Deputy Chief
Department of Monetary and
Financial Analysis
Bank of Canada

Cynthia Louch
Director, Information
Systems
CDIC

CDIC Committees

Board of Directors Committees

Board committees are made up exclusively of Board members.

Executive Committee

The Executive Committee deals mainly with emergencies, highly sensitive matters, or other matters delegated to it by the Board of Directors. The Chairperson of CDIC chairs the committee.

Audit Committee

The Audit Committee has primary responsibility for overseeing internal controls, the reliability of financial information, the annual audit, and the special examination conducted every five years by the Auditor General of Canada. The committee is also responsible for recommendations to the Board of Directors regarding approval of the annual financial statements. The chairman of the committee is H. G. Emerson.

Employee Relations Committee

The Employee Relations Committee's mandate is to review and make recommendations to the Board regarding personnel policies, training, succession planning, compensation, compliance with employee-related legal requirements, grievances and the general state of employee relations. The chairman of the committee is Colin P. MacDonald.

Internal Management Committees

In addition to the Executive Management Committee described earlier in this section, CDIC uses a number of internal advisory committees in its day-to-day operations. These committees include the Asset/Liability Management Committee, the Credit Committee, the Information Systems Executive Steering Committee, the Security Committee, the Senior Management Committee, the Health and Safety Committee, the Human Resources Committee, and the Job Evaluation Committee.

Advisory Committees

Advisory committees are established on an ad hoc basis to assist the Corporation in developing and executing policies, to provide expert advice on specific subjects, and to facilitate effective communication between members and CDIC. During the year, CDIC had three such committees.

The ***Advisory Committee on Risk Assessment and Intervention Policies*** is responsible for reviewing and advising the management and Board of CDIC on risk assessment methodology and procedures, intervention processes and other related matters.

Chair
Peter C. Maurice
Vice-Chairman
CT Financial Services Inc.

Secretary
Ken Mylrea
Director General, Insurance
CDIC

Legal Counsel
Donald E. Milner
Partner
Fasken Campbell Godfrey

Members

William T. Brock
Deputy Chairman
The Toronto-Dominion Bank

Richard S. Buski
Partner and Chairman
National Banking Group
Coopers & Lybrand

Guy L. Saint-Pierre
Senior Vice-President,
Insurance and Risk Assessment
CDIC

Michael White
President and Chief
Operating Officer
National Trust Company

The ***Deposit Insurance Information By-law Industry Consultative Committee*** initially reviewed and contributed to the refinement of the pre-clearance system for member institutions' deposit products. This committee will continue to meet in an advisory capacity to review with CDIC the administrative aspects of the pre-clearance system as it is implemented and to advise on any future issues.

Chair
Jean Pierre Sabourin
President and CEO
CDIC

Vice-Chair
Sandra Chisholm
Director of Standards and
Insurance
CDIC

Members

Perry Eisenschmid
Vice-President, Savings and
Investments
Asset Management
CIBC

Doug Ellis
Senior Vice-President,
Financial Services Division
The Toronto-Dominion Bank

Laura Gaugan
Adviser, Financial
Institutions and Trade
CBA

Moira Gill
Government Relations
Adviser
Canada Trust

Maia MacNiven
Assistant Corporate Secretary,
Government and Industry
Relations
National Trust Company

Peter Stone
Senior Manager, Deposit
Accounts and Term
Investments
Royal Bank

The ***Real Estate Advisory Panel*** reviews, evaluates and makes recommendations on proposals brought forward by management with respect to the realization of major real estate assets in which the Corporation has an interest.

Chair
Daniel F. Sullivan
Deputy Chairman
ScotiaMcLeod Inc.

Board of Directors Liaison
Bernard I. Ghert
President
Ghert Realty Holdings Ltd.

Secretary
Christopher J. Porter
Director, Claims and Recoveries
CDIC

Members

J. Lorne Braithwaite
President and Chief Executive Officer
Cambridge Shopping Centres Ltd.

Marcel J. Casavant
Chairman
J. J. Barnicke Ltd.

H. Roger Garland
Vice-Chairman
Four Seasons Hotels and Resorts

Randy M. Grimes
Director
IBI Group

Stephen E. Johnson
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The Dorchester Corporation

E. John Latimer
President
Monarch Development Corporation

William H. Levine
Chairman
Western Corporate Enterprises Inc.

Alvin G. Poettcker
President
REDEKOP Properties Inc.

Kenneth Rotenberg
Chairman
Rostland Corporation

Meetings and Attendance[1] (April 1, 1996, to March 31, 1997)

		BOARD COMMITTEES		
	BOARD OF DIRECTORS	Executive Committee	Audit Committee	Employee Relations Committee
Number of Meetings	**7**	**2**	**4**	**2**
Attendance:				
G. L. Reuber - Chairperson	7	2	4	2
V. Bergeron *	4		3	
H. M. Caron **	3		1	
H. G. Emerson	5		4	
B. I. Ghert	7	2		
C. P. MacDonald	7			2
Ex officio members (alternates)				
G. G. Thiessen (S. Vachon)	7			
J. R. V. Palmer (J. Heyes)	7	2	4	
D. A. Dodge (B. Hamilton)	7			
J. Thompson ***	4			1

* *Appointed August 7, 1996*
** *Retired August 7, 1996*
*** *Appointed July 23, 1996*

[1] *Includes meetings conducted by telephone and attendance at other meetings by telephone rather than in person.*

FINANCE/TREASURY BOARD GUIDELINES – 1996 *(ABBREVIATED)*

Guidelines	Comments
1 Board explicitly assumes responsibility for the stewardship of the Corporation: i) Strategic direction and corporate plan ii) Identification and management of risks iii) Succession plan iv) Information systems and management practices v) Audit regime	i) Board reviews and approves the strategic direction in the annual *Corporate Plan*. ii) Done by Board on a regular basis. iii) The Employee Relations Committee of the Board reviews the succession plan annually and brings any recommendations to the Board for approval. iv) Delegated by the Board to management and monitored regularly. v) Audit activities are delegated to the Audit Committee, which reports to the Board with recommendations, if any, for approval.
2 Board examines its public policy objectives and legislated mandate: i) Document public policy objectives. ii) Appreciate contemporary tradeoffs: public policy and commercial objectives. iii) Assess relevance of mandate.	The Board considered its statutory objects, what they mean, and how achievement is assessed in July 1996.
3 Ensure the Corporation communicates effectively with the Crown, other stakeholders, and the public.	Communications conducted through the *Corporate Plan*, as approved by the Board; the *Annual Report*; regular meetings with the Minister, the Superintendent of Financial Institutions, the Deputy Minister of Finance, the Governor of the Bank of Canada, the Auditor General of Canada, and other officials; meetings with industry associations and representatives; and meetings of the Financial Institutions Advisory Committee, the Senior Advisory Committee, CDIC Board of Directors committees and advisory committees.

Finance/Treasury Board Guidelines – 1996 *(continued)*

Guidelines	Comments
4 Board and management develop an effective working relationship. i) Ensure the appropriate allocation of responsibilities between the Board and management. ii) Establish an accountability relationship for the CEO to the Board.	i) More specific descriptions of the responsibilities of Board members, the Chairperson, and the President and CEO are being developed in 1997 by the Executive Committee and will be reported to the Board with recommendations, if any, for approval. ii) CEO's performance: Annually reviewed by the Chairperson and the Executive Committee and reported to the Board with recommendations, if any, for approval.
5 Board ensures it can function independently (of management).	The CDIC Act states that the Board is responsible for administering the affairs of the Corporation "in all things...." Certain functions are delegated to management, and management is held responsible to the Board. In its recent review, the Board examined its structures, processes, and procedures, including the roles of the Chairperson, the CEO, *ex officio* directors, Board committees, and conflicts of interest.
6 Periodically i) Assess CEO's position. ii) Evaluate CEO's performance.	i) See 4 i). ii) See 4 ii).
7 Board: i) Assesses its effectiveness. ii) Initiates renewal of the Board.	i) Corporate governance review completed in 1996. ii) Profiles for private-sector directors (skill-set specifications) were prepared by the Board to assist the Minister in proposing names for Governor-in-Council appointments.

FINANCE/TREASURY BOARD GUIDELINES – 1996 *(continued)*

Guidelines	Comments
8 Directors receive orientation and education programs that are appropriate to their needs.	Briefing sessions are held for new directors. Formal and informal briefings are held on an ongoing basis. Informal seminars on various issues relevant to CDIC are conducted prior to most Board meetings.
9 Board reviews the adequacy and form of compensation for directors. • Governor in Council sets out the compensation level for directors, the Chairperson and the CEO. • Government seeks advice.	Executive Committee reviews compensation levels annually and reports to the Board with recommendations, if any, for approval.
10 Board assumes the responsibility for developing the Corporation's approach to governance issues. i) A corporate governance working agenda. ii) Description of approach in *Annual Report*. iii) Possible delegation to governance committee.	i) Regular annual review, with major review every three years. As well, specific responses/follow-ups to the Guidelines are being developed. ii) Yes. iii) No — Corporate governance dealt with by the entire Board.

PUBLIC INFORMATION AND ASSISTANCE

CDIC's services and publications to provide information about deposit insurance include the following:

Public Awareness Activities

- Toll-free telephone service: **1-800-461-CDIC** (1-800-461-2342)
- World Wide Web site: **http://www.cdic.ca**
- E-mail address: **info@cdic.ca**
- CDIC Information brochure entitled *Protecting Your Deposits*
- CDIC Membership brochure

CDIC Publications

Corporate

- Annual Report
- Summary of the Corporate Plan

By-laws

- Canada Deposit Insurance Corporation General By-law
- Deposit Insurance Information By-law
- Joint and Trust Account Disclosure By-law
- Premium Surcharge By-law

Information Bulletins

- CDIC Membership Signs
- Deposit Insurance Information By-law: Implementation—Phase 1
- Joint and Trust Account Disclosure By-law: Member Institutions' Records
- Joint and Trust Account Disclosure Circular

Standards of Sound Business and Financial Practices

- Capital Management
- Credit Risk Management
- Foreign Exchange Risk Management
- Interest Rate Risk Management
- Internal Control
- Liquidity Management
- Real Estate Appraisals
- Securities Portfolio Management

Other

- Application and Policy of Deposit Insurance
- Assessment and Reporting Program for CDIC's Standards of Sound Business and Financial Practices

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