

Advisory

Subject: Pillar 3 Disclosure Requirements

Category: Accounting

Effective Date: November 2007

The Basel Committee on Banking Supervision published an updated version of *Basel II:* International Convergence of Capital Measurement and Capital Standards: A Revised Framework - Comprehensive Version (the Basel II framework) in June 2006. The third pillar of this framework describes the disclosure requirements for institutions. This advisory provides additional clarification on the implementation of these requirements for federally regulated deposit-taking institutions.

1. Application of Pillar 3

As Pillar 3 is an important part of the Basel II framework, the Pillar 3 disclosure requirements apply, as appropriate, to all institutions¹ implementing the Basel II framework. As per paragraph 822 of the Basel II framework, institutions are expected to disclose tier 1 and total capital for certain significant subsidiaries. OSFI does not plan to provide a specific definition of significant subsidiaries; rather, institutions should be guided by market expectations to determine the disclosure for subsidiaries.

Institutions should note that the content of the disclosures, particularly the qualitative requirements, are tailored to the nature, size, and complexity of the institution. Thus, smaller and/or less complex institutions will only need to disclose relevant parts of the Pillar 3 requirements. Institutions should refer to paragraphs 817 and 819 of the Basel II framework, which address the issues of materiality and proprietary information in the context of the Pillar 3 disclosures.

Additionally, and consistent with the application of the *Annual Disclosure Requirements* Guideline (D-1), the Pillar 3 disclosure requirements do not apply to subsidiaries that are federally regulated deposit-taking institutions where:

Banks and bank holding companies to which the *Bank Act* applies and federally regulated trust or loan companies to which the *Trust and Loan Companies Act* applies are collectively referred to as "institutions".





- deposit liabilities are fully guaranteed by the parent and the parent is a federally regulated deposit-taking institution that meets the annual disclosure requirements; or
- liabilities are fully guaranteed by the parent and the parent is a deposit-taking institution whose debt instruments are rated not less than "investment grade" by a widely-recognized rating agency.

As well, OSFI will allow some flexibility with respect to disclosures made by foreign bank subsidiaries whose parent is subject to disclosure requirements under Basel II. If the foreign bank subsidiary is not exempt from making the Pillar 3 disclosures as per the above criteria, there is an ability to apply to OSFI to be exempt from the Pillar 3 disclosures based on the disclosures of its parent institution.

Institutions are required to disclose information that is relevant to their activities and their chosen Basel II approaches. For example, institutions implementing the Standardized Approach to credit risk are required to make those disclosures associated with the Standardized Approach. Institutions should refer to the tables contained in Part 4 of the Basel II framework (www.bis.org) to determine which requirements are applicable to their institution.

As part of the Pillar 3 requirements, bank holding companies are required to disclose the amount of surplus capital in life insurance subsidiaries included in total capital. In addition, as leverage is a key factor that markets monitor to assess financial strength, bank holding companies should provide information on their amount of debt in relation to total capital.

2. Frequency of Disclosures

Although the Basel II framework requires that most disclosure be made on a semi-annual basis, the frequency of the quantitative disclosures made by Canadian institutions should align with financial reporting in Canada. Therefore, institutions are required to make quantitative disclosures on a quarterly basis. Qualitative disclosures (e.g., general information on an institution's risk management objectives and policies) can be made on an annual basis. For smaller, less complex institutions with stable risk profiles, annual reporting may be acceptable for all disclosures, both quantitative and qualitative. When an institution publishes information on an annual basis only, it should include sufficient information to support this frequency of disclosure.

3. Timing of Implementation

As the Pillar 3 disclosures provide information related to the Basel II framework, these disclosures² should be made once the new framework has been implemented (i.e., beginning of fiscal 2008). OSFI encourages institutions to begin disclosing information under Pillar 3, particularly the quantitative disclosures, in Q1 2008. However, OSFI will allow some flexibility throughout 2008 and require institutions to meet all Pillar 3 disclosure requirements using fiscal year-end 2008 data. These disclosures should be made within a reasonable timeframe following fiscal year-end (e.g., at the same time as the release of detailed 2008 financial results).

4. Location of Disclosures

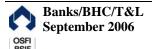
As per the Basel II framework, all institutions are required to make the Pillar 3 disclosures to the public. However, Pillar 3 disclosures are not required to be audited by external auditors unless otherwise required by another authority (e.g., accounting standards, securities regulations). For those disclosures that are not mandatory under accounting or other requirements, OSFI will allow institutions discretion on the location of the Pillar 3 disclosures (e.g., annual report, quarterly report, Web site, etc.). Nevertheless, institutions are encouraged to provide all related information in one location to the extent possible.

5. Compliance with Pillar 3

OSFI expects institutions to comply with the Pillar 3 requirements. Issues of non-compliance will be addressed on a case-by-case basis through bilateral discussions with institutions. To aid in the identification of non-compliance, institutions implementing an internal-ratings based (IRB) approach to credit risk are required to submit a roadmap that identifies whether the Pillar 3 requirements have been met and indicates the frequency and location of these disclosures. In instances where disclosures are not made, explanations should be provided.

OSFI has developed a roadmap template³ to be completed by institutions. However, OSFI will allow institutions to submit information in another format, provided all of the above information is included in the submission to OSFI. The roadmap (or equivalent information) should be submitted after the Pillar 3 disclosures have been published (i.e., following fiscal year-end 2008). Institutions implementing an IRB approach should submit to OSFI a sample or mock-up of the planned Pillar 3 disclosures. This should be submitted two quarters prior to the disclosures being made public.

³ OSFI's Pillar 3 Roadmap is available at www.osfi-bsif.gc.ca.



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² Any of the Pillar 3 disclosures required by another authority (e.g. accounting standards), should be disclosed as required by that authority.