Office of the Superintendent of Financial Institutions Canada | Bureau du surintendant des institutions financières Canada

Guideline

Subject: **Annual Disclosures (Banks, Foreign Bank Branches, Federally Regulated Trust and Loan Companies, and Cooperative Credit Associations)**

Category: **Accounting**

No: **D-1** **Date:** **July 1997**
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Introduction

This guideline outlines the financial disclosure OSFI expects institutions[1] to provide in or with their annual financial statements or annual reports in addition to, or in conjunction with, the disclosures required by the *CICA Handbook* and other OSFI guidelines. Institutions that do not prepare an annual report should make these disclosures in the notes to the annual financial statements or in a supplementary management report appended to the annual financial statements. Foreign bank branches that do not prepare annual financial statements should make these disclosures in the portion of their annual OSFI return that is covered by the auditor's opinion and in a supplementary management report filed with the annual OSFI return.

The guideline applies to cooperative credit associations, banks, FBBs, and federally regulated trust and loan companies, and to their federally regulated deposit-taking subsidiaries. It does not apply to provincially regulated subsidiaries, nor to subsidiaries that are federally regulated deposit taking institutions themselves where their

- 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.

[1] For the purposes of this guideline, “institutions” refers to federally regulated deposit-taking institutions, including authorized foreign banks in respect of their business in Canada (foreign bank branches, or FBBs).

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Part 1 - Quantitative Disclosure

Part 1 of the guideline sets out minimum levels of quantitative disclosure for certain financial statement items. Institutions are encouraged to develop a level of disclosure that exceeds this guideline's minimum expectations and to provide information in a structure consistent with that used for management or internal reporting purposes. The minimum disclosure would be at a level of detail that makes the data useful to analysts and other readers of the information. Disclosures by category or type need not be met where the amounts are not material.

Investment and Lending Portfolios

Securities

The institution should disclose the balance sheet values and fair values of its securities portfolio showing in separate categories:

- (a) securities held to maturity,
- (b) available-for-sale securities,
- (c) securities held for trading[2], and
- (d) securities designated as held for trading (Fair Value Option)[3].

The amounts, by residual term to maturity of the securities referred to in categories (a), (b), and (d), should also be disclosed, including at least the following time bands:

- (i) one year or less,
- (ii) over one year to five years,
- (iii) over five years, and
- (iv) no specific maturity.

Separate disclosure is recommended, within the above four categories, (a) to (d), for any type of securities, that constitutes 10% or more of the fair value amount of the entire securities portfolio.

For each type of security held to maturity, the institution should provide a reconciliation between the balance sheet value and the fair value of the securities showing separately unrealized gains and unrealized losses.

[2] Per CICA handbook section 3855.19(f) (i)

[3] Per CICA handbook section 3855.19(f) (ii)

Loans and Acceptances[4]

Disclosure of the loan and acceptance portfolio reported at its balance sheet value should consist of at least the following categories:

(a) residential mortgages,
(b) non-business loans to individuals,
(c) business and government loans, and
(d) other.

Separate disclosure is recommended for any group of loans with similar characteristics within each of the above categories, such as type of borrower or industrial sector that constitutes 5% or more of the carrying amount of the entire loan and acceptance portfolio.

The institution should disclose the fair value and carrying amount of loans and acceptances in total, and the fair value and carrying amount relating to Canada and any other country that represents 10% or more of total loans and acceptances in the portfolio.

Impairment

The institution should disclose information on impaired loans, the allowance for impairment and the charge for impairment in accordance with *CICA Handbook*, Section 3025 and OSFI Guideline C-1, *Impaired Loans*.

Taxable Equivalent Basis

When the institution earns tax-exempt income from certain investments including common and preferred shares and wishes to disclose this income on a taxable equivalent basis, it should disclose its interest income and net interest income on that basis as supplementary information outside the financial statements. Disclosure should include a narrative description of the nature and magnitude of the gross-up of tax-exempt income.

Interest Rate Sensitivity Position

The following disclosure is required by Paragraph 49 of *CICA Handbook* Section 3861, *Financial Instruments - Disclosure and Presentation*:

> *For each class of financial assets and financial liabilities, both recognized and unrecognized, an entity should disclose information about its exposure to interest rate risk, including:*
>
> *(a) contractual repricing or maturity dates, whichever dates are earlier; and*
> *(b) effective interest rates, when applicable.*

[4] Per CICA handbook section 3855.19 (h)

In disclosing the information required by Paragraph 49(a), the institution should present the carrying amounts of financial instruments in tabular form, grouped by those that are contracted to mature or reprice, as a minimum:

(i) within three months of the balance sheet date,
(ii) more than three months to one year from the balance sheet date,
(iii) more than one year to five years from the balance sheet date, and
(iv) more than five years from the balance sheet date.

The carrying amounts of items at floating interest rates and of items that are not sensitive to interest rates should also be provided.

The institution should disclose the amount of the matching gap between assets and liabilities within each time band and separately disclose the amount of the gap in unrecognized items within each time band.

The institution should provide a quantitative measure of its sensitivity to interest rate risk such as the effects of an assumed 1% (100 basis points) change in market interest rates at the balance sheet date reporting the impact on net interest income for the proceeding (next) twelve month period. The institution should indicate the basis on which it has prepared the information, including any significant assumptions.

Part 2 - Risk Management and Control Practices

Part 2 outlines the disclosures OSFI expects regarding the risk management and control practices adopted by the institution.

Each institution should identify and describe the risks that are significant to its business. These include, but are not limited to, credit risk, liquidity risk, interest rate risk and foreign exchange rate risk. The institution should describe the way in which it monitors and controls such risks. It should also set out the responsibilities of the board of directors (or principal officer in the case of FBBs) and senior management for risk management, including policy setting, implementation, monitoring and review.

The institution should discuss the extent of any significant exposures to areas where there recently has been, or there is the potential for, significant loss due to industry specific factors or general industry recession and outline the steps it has taken to contain risks in these areas. Similarly, the institution should identify its major lines of business and describe the controls it has in place to quantify and contain the risks to the institution from exposure to these lines of business.

The institution should also discuss methods of measuring and controlling other market-related risks, such as settlement risk, equity risk and commodity risk, where they are significant.

Where the institution is a subsidiary of another deposit-taking institution and where one or more of the risks discussed below is managed by the parent as part of a broader risk management system, then a statement to that effect will suffice. However, to the extent that under such a system the subsidiary may still be exposed to risks, including credit risk exposure to the parent, these risks should be disclosed and discussed.

Credit Risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. This risk can relate to recognized financial assets as well as unrecognized financial assets such as guarantees, letters of credit, commitments and derivative instruments with positive market values.

The institution should discuss its credit risk management policies, including the role of the board and management in the development, review, approval and implementation of credit risk management policies, and the procedures in place to effectively monitor and control the credit function. The discussion of the credit risk management policies should include information on the methods used by the institution to identify existing and potential risks inherent in the portfolio and the policies that exist for monitoring and controlling these risks. The institution should include a description of its risk measurement and rating classification systems.

Liquidity Risk

Liquidity risk is the risk that an entity will encounter difficulty in raising funds to meet commitments associated with financial instruments. The institution should identify the committees of the board and management with responsibility for liquidity management, including the development, review, approval and implementation of liquidity management policies, and the procedures in place to effectively monitor and control the function. It should describe the methods used for measuring the institution's current and projected future liquidity.

The institution should include a description of its policies and performance with respect to:

- controlling the cash flow mismatch between on- and off-balance sheet assets and liabilities;
- maintaining stable and diversified sources of funding;
- accessing alternative sources of funding, if required; and
- ensuring it has sufficient liquid assets on hand in relation to its daily cash flows.

It should also explain other methods it uses for liquidity management, for example, asset securitization.

Interest Rate Risk

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates and that such movements will have an adverse effect on the financial condition of the institution. It can arise from trading and non-trading activities. An institution should set out its objectives and associated business strategy in interest rate risk management.

The institution should discuss its interest rate risk management policies, including the role of the board (or the principal officer of an FBB) and management in the development, review, approval and implementation of interest rate risk policies, and the management program for effectively monitoring and controlling the interest rate risk. The discussion should include information on the policies that exist for measuring the institution's interest rate risk exposure, including the frequency of measurement.

The institution should identify and describe the analytical techniques it uses (e.g., gap analysis, duration analysis, simulation models). It should also set out the key sources of interest rate risk within its portfolio given the level and shape of the yield curve at the time of disclosure.

Consistent with Guideline D-6, *Derivatives Disclosure*, the institution should explain how it uses derivative instruments to manage interest rate risk and provide quantitative information on the extent to which these instruments are used.

Foreign Exchange Rate Risk

Foreign exchange rate risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. It can arise from trading and non-trading activities.

The institution should discuss its foreign exchange risk management policies, including the role of the board (or the principal officer of an FBB) and management in the development, review, approval and implementation of foreign exchange risk management policies, and the procedures in place to effectively monitor and control the foreign exchange risk function.

The institution should identify and describe the analytical techniques used to measure foreign exchange rate risk, the limits it imposes and the frequency of measurement. The institution should also set out the key sources of foreign exchange rate risk within its portfolio (e.g., unhedged net investments in foreign operations or active position-taking for the institution's own account). It should also provide information on how it measures foreign exchange trading gains and losses.

Consistent with Guideline D-6, *Derivatives Disclosure*, the institution should explain how it uses derivative instruments to manage foreign exchange rate risk and provide quantitative information on the extent to which these instruments are used.

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