Guideline Impact Analysis Statement

Pillar 3 Disclosure Requirements

Date: April 2017

I. Background

OSFI supports relevant disclosures as a way to ensure stakeholders have access to key risk information to help them gain a thorough understanding and knowledge of a deposit-taking institution's activities. The importance of disclosure is recognized by many bodies[1] as a key tool for decision-making and market discipline. Accordingly, disclosures help OSFI to meet our mandate of protecting deposit holders by ensuring appropriate information is available for the public to understand the financial condition of Canadian federally regulated deposit-taking institutions[2] and the risks to which they are exposed.

One outcome of the financial crisis was the need for improvements in disclosures of risk information. OSFI has been reviewing disclosure recommendations over the past several years and incorporating requirements for our regulated institutions where they are appropriate and relevant. This guideline impact analysis statement deals with the application of the Basel Committee publication on the standards for the *Revised Pillar 3 Disclosure Requirements*[3] (Revised Basel Pillar 3 standard) issued in January 2015. The Revised Basel Pillar 3 standard introduce standardized granular templates for disclosure by internationally active banks at the consolidated level. These revisions replace most of Basel II and Basel 2.5 Pillar 3 disclosure requirements[4] and aim to improve comparability between banks and across jurisdictions leading to timely reporting and transparency in the calculation of risk weighted assets for key areas of risk.

The Revised Basel Pillar 3 standard represents Phase I of the Basel Committee Pillar 3 disclosure project. Phase I supersedes the disclosure requirements issued under Basel II (including subsequent Basel II enhancements and revisions) in the areas of credit risk, counterparty credit risk, market risk and securitization activities.

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[1] For example, the Financial Stability Board considers disclosure of key importance. For additional information, please see the FSB's Enhanced Disclosure Task Force reports.

[2] Banks and bank holding companies to which the *Bank Act* applies, federally regulated trust or loan companies to which the *Trust and Loan Companies Act* applies and cooperative retail associations to which the *Cooperative Credit Association Act* applies are collectively referred to as "deposit-taking institutions".

[3] Basel Committee Revised Pillar 3 Disclosure Requirements, January 2015: http://www.bis.org/bcbs/publ/d309.html

[4] Annex II of the Basel Committee *Revised Pillar 3 Disclosure Requirements* provides a list of Pillar 3 disclosure requirements issued by the Basel Committee that are superseded or still in force.

Phase II of the Pillar 3 disclosure project will be addressed at a later date and relates to:

i. New disclosures to enhance the revised Pillar 3 framework,

ii. Revisions and additions to the Pillar 3 framework arising from ongoing reforms to the regulatory framework that are different from those covered by Phase I, and

iii. Consolidation of all existing and prospective Basel Committee disclosure requirements into the Pillar 3 framework.

The guideline on Pillar 3 Disclosure Requirements will replace OSFI's November 2007 Advisory, which addresses expectations for the implementation of the Basel II disclosure framework published in 2006 and applied to all federally regulated deposit-taking institutions.

II. Problem Identification

Market discipline has long been recognized as a key objective of disclosures. In the wake of the 2007-09 financial crisis, it became apparent that the existing Pillar 3 disclosures did not adequately promote the identification of internationally active banks' material risks and did not provide sufficiently comparable information to enable market participants to assess a bank's overall capital adequacy and make comparisons with its peers.

Given the volume and complexity of the Revised Basel Pillar 3 standard, Canadian federally regulated deposit-taking institutions would benefit from additional clarity regarding OSFI's expectations on the application of these regulatory public disclosures.

In addition, the increased volume and complexity of the disclosures has led OSFI to consider whether all federally regulated deposit-taking institutions should be subject to the full set of Pillar 3 disclosures.

III. Objectives

OSFI's objective is to ensure that disclosures continue to improve comparability and consistency of disclosures for deposit-taking institutions. This provides the public with the opportunity to evaluate and hold boards and senior management responsible for the risk-taking activities within their respective deposit-taking institutions.

IV. Options and Assessment

In drafting the Pillar 3 disclosure requirements guideline, OSFI's key considerations related to the scope, timing and format of the Revised Basel Pillar 3 standard to our regulated institutions.

Below are OSFI's proposals for the application of the Revised Basel Pillar 3 standard:

A. *Scope*

1. Domestic Systemically Important Banks (D-SIBs)[5]

The Revised Basel Pillar 3 standard issued by the Basel Committee is for application to internationally active banks at the top consolidated level. In considering the need for adopting the Revised Basel Pillar 3 standard for Canadian D-SIBs, OSFI took into account the relevance and importance of improving the overall comparability and consistency of disclosures across Canadian D-SIBs as well as alignment with internationally active banks in other jurisdictions. It is important that Canadian D-SIBs continue to retain high levels of public confidence. This can be achieved, in part, through their having robust disclosure practices covering their financial condition and risk management activities that are among the best of their international peers.[6]

OSFI considered whether a partial or modified form of adoption would be more relevant and less resource intensive depending on the scale of reduction. However, this approach would not provide a comprehensive summary of a bank's main activities and significant risks, nor would it provide meaningful comparisons with internationally active banks.

<u>Market risk disclosures</u>

Phase II of the Basel Committee Pillar 3 disclosure project contains proposed disclosure requirements for market risk that supersede those issued in January 2015 as part of Phase I of the Basel Committee Pillar 3 disclosure project. An assessment was made to determine whether D-SIBs should adopt the market risk disclosures under Phase I or continue with the disclosures under Basel 2.5 framework until the Phase II market risk disclosures come into effect.

Option 1 *– Adoption and application of market risk disclosures under Phase I*

Adoption of the Phase I market risk disclosures would ensure comparability and consistency of disclosures across D-SIBs and among their international peers. However, it would be onerous for D-SIBs to implement market risk disclosures for October 31, 2018 and then have these disclosure requirements superseded with those issued under Phase II of the Basel Committee Pillar 3 disclosure project which would become effective soon after Phase I.

Option 2 *– Continue with market risk disclosures under Basel 2.5 framework*

Continuing with current market risk disclosures under Basel 2.5 framework would be less onerous for D-SIBs, as they would implement one set of market risk disclosures when

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[5] Chapter 1 of the Capital Adequacy Requirements (CAR) Guideline identifies D-SIBs as Bank of Montreal, Bank of Nova Scotia, Canadian Imperial Bank of Commerce, National Bank of Canada, Royal Bank of Canada and Toronto-Dominion Bank. Non-D-SIBs consist of all other federally regulated deposit-taking institutions that are not D-SIBs. Non-D-SIBs are also known as small and medium size banks.

[6] OSFI CAR Guideline, Chapter 1, Annex 1, paragraph 11.

Phase II of the Basel Committee Pillar 3 disclosure project becomes effective. Although, this option does not provide exact comparability of the Canadian D-SIBs with their international peers during the period before the Phase II market risk disclosures come into effect, this is mitigated by the fact that the D-SIBs all meet the current Enhanced Disclosure Task Force (EDTF) market risk disclosures which address the Phase I market risk requirements.

2. Non-D-SIBs

For deposit-taking institutions that are not defined as D-SIBs, application of Revised Basel Pillar 3 standard should be commensurate with the nature, size, complexity and risk profile of each deposit-taking institution.

An assessment was made to determine whether all non-D-SIBs should apply the Revised Basel Pillar 3 standard. If the requirements were deemed to be applicable, then a determination would be needed as to whether the disclosures should be in full form, partial form or to continue applying existing disclosure requirements until all phases of the Basel Pillar 3 disclosures project are complete.

OSFI identified three options for consideration of non-D-SIBs' nature, size and complexity.

Option 1 - *Full form application of Revised Basel Pillar 3 standard*

Full form application of Revised Basel Pillar 3 standard would entail the non-D-SIBs implementing all tables and templates under the Revised Basel Pillar 3 standard that were designed for internationally active banks. Although applying the full suite of Basel Pillar 3 standard would provide comprehensive reporting of activities and risks, OSFI considers that the volume and complexity of these disclosures would not reflect the nature, size and complexity of non-D-SIBs.

Option 2 - *Partial form application of Revised Basel Pillar 3 standard*

Partial form application of Revised Basel Pillar 3 standard would result in a reduced number of disclosures in comparison to full application, but would still require extensive new disclosures which would likely not reflect the size, nature and complexity of the non-D-SIBs.

Option 3 - *Continuing with existing Pillar 3 Disclosure framework*

Continuing to apply the Pillar 3 disclosures that non D-SIBs are currently making for Basel II and 2.5 frameworks would provide a sufficient level of disclosures to understand the risk for their size, nature and complexity. Additionally these disclosures are familiar to both preparers and users of non-D-SIBs information. OSFI is not aware of concerns of these disclosures for non-D-SIBs.

Consideration of Non-D-SIBs to be exempted from Revised Basel Pillar 3 standard:

Additionally, OSFI considered if there are deposit-taking institutions that do not need to make regulatory public disclosure due to their nature. Thus, it is determined that the following do not need to make Pillar 3 disclosures:

a) Foreign bank branches – It was determined that these institutions do not pose systemic risk and have limited activities or minimal residual exposure.

b) Institutions that do not take deposits – This category includes service-oriented business models and do not participate in capital market activities.

c) Subsidiaries of Canadian deposit-taking institutions that report consolidated results to OSFI – This aims to avoid duplication as parent deposit-taking institutions will already report Pillar 3 disclosures at a consolidated level.

B. Timing

1. D-SIBs

In determining the effective date for implementation, OSFI considered four options: the fiscal year-end reporting dates for 2016, 2017, 2018 and 2019.

Option 1*- Implementation for 2016 fiscal year-end*

An implementation of the Revised Basel Pillar 3 standard for 2016 year-end would provide an example for which Canadian D-SIBs can demonstrate that their regulatory disclosures would be among the best of their international peers. However, D-SIBs would be the first amongst its international peers to report Pillar 3 disclosures due to their October year-end reporting cycle. This option would also provide the D-SIBs with the least amount of lead time to build systems that would gather data and incorporate proper quality controls for reporting requirements.

Option 2*- Implementation for 2017 fiscal year-end*

An effective date of fiscal year-end 2017 would provide D-SIBs sufficient time for designing and implementing any necessary systems to collect the required information and incorporate proper quality controls for reporting purposes. This option would ensure that they are not the first reporters of Pillar 3 disclosures. However, other major jurisdictions have indicated plans for further delayed implementation of the Pillar 3 disclosures. In addition, this option would coincide with the implementation of IFRS 9 *Financial Instruments* and would not provide users the ability to compare Canadian D-SIBs with other internationally active banks for 2016 fiscal year-end reports.

Option 3*- Implementation for 2018 fiscal year-end*

Deferring implementation until fiscal year-end 2018 has the same benefits and costs as the 2017 year-end implementation option. However, with this option, there is less of a timing conflict with the implementation of IFRS 9 and is better aligned with the planned implementation dates for internationally active banks in other major jurisdictions.

Option 4 *– Implementation for 2019 fiscal year-end*

Deferring implementation until fiscal year-end 2019 has the same benefits and costs to the 2018 year-end implementation option. However, this option provides the D-SIBs with the most time but would position D-SIBs to be among the later banks to implement when compared to internationally active banks in other major jurisdictions.

2. Non-D-SIBs

If non-D-SIBs were to fully implement the Revised Basel Pillar 3 standard, OSFI considered the fiscal year-end reporting dates for 2016, 2017, 2018 and 2019 and deferring implementation until the Basel Committee fully completes the Pillar 3 disclosures project. OSFI understands that non-D-SIBs would require adequate lead time and sufficient resources for a fulsome implementation. OSFI also considered the volume of disclosures and the impact it would have relative to the nature, size and complexity of non-D-SIBs.

C. Format

The Revised Basel Pillar 3 standard is prescribed in both fixed and flexible formats. The fixed format tables and templates provide for greater comparability across deposit-taking institutions and are located in a distinct Pillar 3 report. The flexible format allows deposit-taking institutions to present the required information in a format that better suits each institution. While greater comparability can be achieved using the prescribed Pillar 3 formats, each deposit-taking institution has unique business models and activities that could benefit from the additional flexibility of using their own disclosure formats.

Disclosures have gone through an evolution since 2012 when the Financial Stability Board tasked the EDTF with addressing key weaknesses in risk disclosures, including regulatory disclosures. D-SIBs have been complying with the EDTF disclosure requirements. However, continuing with EDTF disclosures alongside Revised Basel Pillar 3 standard causes duplication for some risk and regulatory disclosures. In an effort to minimize duplication of disclosures, D-SIBs can remove those EDTF disclosures that are effectively disclosed by Pillar 3 disclosures.

V. Consultations

In January 2016, the guideline was published in draft form on the OSFI website for an eight-week public consultation period. Comments received were taken into consideration in the final guideline. All material comments have been summarized in a non-attributed format and include a summary of how each comment was addressed. The industry was informed through OSFI's August 2016 letter on *Pillar 3 Disclosure Requirements* of the delayed implementation to fiscal year-end 2018.

VI. Recommendations

1. D-SIBs

a) D-SIBs are expected to fully apply Revised Basel Pillar 3 standard (see (b) below for exception to market risk disclosures) to ensure their risks are fully disclosed on a consistent basis and are comparable to each other and their international peers. This is considered necessary for the D-SIBs to ensure they continue to retain the confidence of the public that they enjoy today.

b) D-SIBs are permitted, at their discretion, to continue applying the market risk disclosures under Basel 2.5 framework until the market risk disclosures under Phase II come into effect.

c) D-SIBs are expected to implement the Revised Basel Pillar 3 standard by the October 31, 2018 fiscal year-end. This two-year deferral gives D-SIBs the time to focus on a high quality implementation of the *IFRS 9 Financial Instrument*s accounting standard and is better aligned with the planned implementation dates for internationally active banks in other major jurisdictions.

d) D-SIBs are expected to follow the templates prescribed in the Revised Basel Pillar 3 standard, along with the expectations set out in OSFI's *Pillar 3 Disclosure Requirements* guideline on the structural aspects for template frequency, format and location.

e) To help minimize duplication of disclosures, D-SIBs can remove those EDTF disclosures that are effectively disclosed by the more granular templates of the Revised Basel Pillar 3 standard. D-SIBs should retain those EDTF disclosures that are not covered by Pillar 3 requirements.

2. Non-D-SIBs

a) Non-D-SIBs are expected to continue to apply the existing Pillar 3 disclosure requirements under the Basel II (including subsequent Basel 2.5 enhancements and revisions)[7] and OSFI's guidelines for Basel III frameworks until OSFI reviews the final completed Basel Committee Pillar 3 disclosure project. This would provide a sufficient level of disclosure that is familiar for the preparers and users of non-D-SIBs information and reflects their size, nature and complexity.

b) Foreign bank branches, financial institutions that do not take deposits and subsidiaries of Canadian federally regulated deposit-taking institutions that report consolidated results to OSFI are exempt from Pillar 3 disclosure requirements.

[7] *Basel II: International Convergence of Capital Measurement and Capital Standards: A Revised Framework – Comprehensive Version*, June 2006. Enhancements to the *Basel II framework* and revisions to the *Basel II market risk framework*, June 2009.

c) Non-D-SIBs are permitted to adopt and disclose any of the tables or templates from the Revised Basel Pillar 3 standard that are relevant to their risks and activities at the same time as the D-SIBs at 2018 fiscal year-end if they choose.

VII. Implementation & Evaluation

OSFI is of the view that the *Pillar 3 Disclosure Requirements* final guideline provides clarity to federally regulated deposit-taking institutions on the implementation of the Basel Committee's Revised Pillar 3 standard. The final guideline will be effective for the 2018 fiscal year-end reporting period of the institution.