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OSFI releases guidelines in response to revised Pillar 3 disclosure requirements

The Basel Committee of Banking Supervision (**BCBS**) is an international banking regulator that aims to strengthen the international banking sector. The BCBS establishes international regulatory frameworks for banks under three pillars, each dealing with different areas of concern. The third pillar covers enhanced risk disclosure and market discipline. In January 2015, the BCBS released its Revised Pillar 3 Disclosure Requirements (**Revised Requirements**) in response to the 2007-2009 financial crisis, which made it clear that the existing Pillar 3 requirements were insufficient at identifying a bank's material risks. The Revised Requirements represent Phase I of the BCBS Pillar 3 disclosure project.

On January 21, 2016, the Office of the Superintendent of Financial Institutions (**OSFI**) released its draft guidelines (**Guidelines**) in response to the Revised Requirements. Once the Guidelines are finalized they will replace OSFI's Pillar 3 Disclosure Requirements Advisory document from November 2007. The Guidelines are open for comment until March 21, 2016.

The Revised Requirements

Guiding Principles

The Revised Requirements flesh out the old Basel II and 2.5 requirements in an effort to promote comparability and consistency among banks. In the older version, the guiding principles were only briefly described and included general comments on encouraging market discipline and consistency. In the Revised Requirements, the BCBS introduced five guiding principles for banks to keep in mind when making their Pillar 3 disclosures. They are, as follows:

1. *Disclosures should be clear*: they should be in a form that key stakeholders can understand and should be communicated through an accessible medium;
2. *Disclosures should be comprehensive*: they should describe the bank's main activities and all significant risks, with any changes to risk exposure being accompanied by a management response;
3. *Disclosures should be meaningful to users*: they should highlight significant current and emerging risks and describe how they are being managed;
4. *Disclosures should be consistent over time*: they should be consistent so readers can identify trends over time, and any changes should be highlighted and explained;
5. *Disclosures should be comparable across banks*: readers should be able to meaningfully compare banks across jurisdictions.

Introduction of Templates

The Basel II and 2.5 requirements only provided a table with qualitative and quantitative disclosures briefly outlined. Under the Revised Requirements, the tables have been expanded to include more detailed information for banks, and multiple templates corresponding to the tables have been introduced. Each template is introduced with statements on its purpose, scope, content, frequency, format and the accompanying narrative that is to be disclosed, followed by the template itself and a definitions section.

Disclosure Schedule

Under the Basel II and 2.5 requirements, the overwhelming majority of disclosure requirements were semi-annual, with only a few exceptions. The Revised Requirements have introduced varied disclosure schedules, based on what makes the most sense for each type of disclosure. While the majority (22) are still semi-annual, a large number (14) are now annual, and a few (4) are quarterly.

Fixed vs. Flexible formats

Each template and table is outlined as having a fixed or a flexible format. Those with a fixed format must be completed in accordance with the instructions. Templates and tables designated as flexible can be completed in the format provided in the Revised Requirements or in a format that better suits the particular bank. If a different format is used then the bank must still ensure the same information is provided in that different format.

Draft Guidelines

Application

The Revised Requirements apply to Canadian domestic systemically important banks (**D-SIBs**) and will replace the existing Basel II requirements in the areas of credit risk, counterparty credit risk, and securitization activities.

The BCBS also introduced new standards for market risk disclosures, however the consultative document for Phase II of the BCBS Pillar 3 disclosure project contained new standards in market risk that would replace the January 2015 Phase I requirements. Thus, OSFI proposed in its Guideline that D-SIBs retain discretion over whether or not they wish to implement the market risk disclosures set out in the Revised Requirements. D-SIBs may continue to follow the Basel II and 2.5 requirements in market risk disclosures until the Phase II requirements come into effect.

OSFI recommends in its Guideline that non-D-SIBs continue to fulfill their existing Pillar 3 disclosure requirements rather than switch over to the Revised Requirements. Once BCBS has completed all the phases of its Pillar 3 disclosure project, OSFI will determine how the disclosure requirements apply to non-D-SIBs.

Disclosed materials

Both D-SIBS and non-D-SIBs should supplement the tables and templates with a narrative commentary. It should, at minimum, explain significant changes and any other issues of interest to market participants.

OSFI recommends that D-SIBs remove Enhanced Disclosure Task Force disclosures that are already effectively disclosed under the Revised Requirement templates.

Pillar 3 disclosures must be publically available, and D-SIBs must have an archive of previous disclosures. D-SIBs must publish their disclosures with their financial statements, and must ensure they are easily located.

Implementation

OSFI proposes that D-SIBs must implement the Revised Requirements for the reporting period ending October 31, 2017. As of this date, they must disclose the required tables and templates (except for market risk disclosures).

Non-D-SIBs may switch to the Revised Requirements or any template/table within them as of the 2017 fiscal year-end reporting.

Next Steps

The BCBS will continue to work on Phase II of its disclosure project. Phase II will include disclosure requirements that were not dealt with in Phase I, such as operational risk and interest rate risk in the banking book. It will also include updated market risk disclosure requirements, as was discussed previously.

Comments

The Guidelines are open for comment until March 21, 2016. Comments can be sent to OSFI by emailing Kenneth Leung at kenneth.leung@osfi-bsif.gc.ca.

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a cautionary note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.