President's Choice Bank

BASEL II PILLAR 3 DISCLOSURES

September 30, 2012

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TABLE 1 – OVERVIEW & SCOPE OF APPLICATION

This document represents the Basel II Pillar 3 disclosures for President's Choice Bank ("PC Bank" or the "Company"). These disclosures are made pursuant to OSFI's Pillar 3 Disclosure Requirements issued in November 2007, pursuant to the Basel Committee on Banking Supervisions update on "Basel II: International Convergence of Capital Measurement and Capital Standards: A Revised Framework – Comprehensive Version" issued in June 2006. Basel II is structured around 3 pillars:

- Pillar 1: Minimum Capital Requirements
- Pillar 2: The Supervisory Review Process
- Pillar 3: Market Discipline

Pillar 3 complements both Pillars 1 and 2, by setting disclosure requirements which will allow market participants to assess key pieces of information on the scope of application, capital, risk exposures, risk assessment processes, and hence the capital adequacy of PC Bank.

This report is unaudited and is reported in Thousands of Canadian Dollars, unless otherwise disclosed.

Presidents Choice Bank Overview

PC Bank is a Schedule I Canadian chartered bank governed by the *Bank Act (Canada)* and is an indirectly wholly owned subsidiary of Loblaw Companies Limited (LCL). In association with other financial institutions, PC Bank offers, under the President's Choice Financial® brand, a complete line of retail financial services products to individuals resident in Canada. The key business lines of PC Bank are as follows:

Credit Card

PC Bank launched its credit card program in 2001 and currently offers the *President's Choice Financial* MasterCard (PC MasterCard) across Canada. The product attributes include no annual fee and a competitive rewards program which allows customers to earn and redeem PC Points for free groceries at LCL stores. PC Bank records the credit card receivables and associated funding on its balance sheet.

Core Banking

PC Bank launched its core banking business in 1998 through a strategic partnership with a major Canadian Chartered Bank ("Strategic Partner"). Under the President's Choice Financial brand, retail banking products are sold online and in LCL stores at banking pavilions operated by the Strategic Partner. All deposits, investments and lending products issued under the PC Financial brand are recorded by the Strategic Partner on its balance sheet. PC Bank earns interest income and fees through this partnership.

GIC's

PC Bank launched a broker originated GIC program in 2010. The GIC's offered by PC Bank are insured by Canadian Deposit Insurance Corporation (CDIC). PC Bank sells nominee name GIC's through a number of brokers in Canada.

PC Bank Risk Management

PC Bank calculates its regulatory capital based on the following methodologies:

- PC Bank manages its credit risk using the standardized approach
- PC Bank is not exposed to market risk as the company does not enter into interest rate, equity, foreign exchange or commodities based derivatives; and
- PC Bank's operational risk is monitored using the Basic Indicator Approach.

PC Bank has implemented a comprehensive Internal Capital Adequacy Assessment Process ("ICAAP") to identify and assess the material risks that PC Bank faces to ensure that sufficient quality and quantity of capital is available. PC Bank is confident that the Pillar I and Pillar II calculations are appropriate given the PC Bank's business model, inherent risks, internal controls and tools to manage risks and residual risks. The results of the ICAAP performed by President's Choice Bank (PC Bank) conclude that PC Bank is strongly capitalized.

The guiding principles of ICAAP are summarized below:

- ***Proportionality***: The design of the Bank's ICAAP is proportionate to the risk level, complexity and scale of PC Bank's activities.
- ***Forward Looking****:* In the process of ICAAP, PC Bank considers not only the existing risks faced but also the emerging risks and future business strategies.
- ***Ongoing exercise:*** PC Bank's ICAAP is not a static one-time process but rather a dynamic and continuous exercise to ensure that the PC Bank has robust risk management systems and possesses sufficient capital at all times for risks.
- ***Evolving-nature***: ICAAP is continuously monitored for improvement in accordance with changes to the risk profile and business plans of PC Bank.
- ***Use test***: The methodology and risk limit structures used to measure and compute risk under ICAAP is integrated within the day to day risk practices of PC Bank through the ERM risk monitoring program. Specific limits and tolerances are monitored for capital & capital ratios on a monthly basis by the ERMC to ensure that PC Bank stays within it risk appetite for all capital risks including those relating to ICAAP.

Corporate Governance

The Company maintains a rigorous corporate governance structure as follows:

- Board of Director's Oversight
    - Risk Committee
    - Audit Committee
    - Conduct Review Committee
    - Governance Committee

- Senior Management Oversight through the following:

    - **Asset Liability Committee (ALCO) –** ensures prudent balance sheet management by ensuring that PC Bank has the appropriate quantity and quality of capital, considering its strategic direction & business plans, its risk profile, its emerging risks and stress tests.

- **Enterprise Risk Management Committee (ERMC) –** provides stewardship over the identification, definition, assessment, management, control, measurement, monitoring and reporting of PC Bank's enterprise risks.
- **Credit Risk Management Committee (CRMC) –** provides a governance structure that oversees the Credit Risk Management program, including a corporate risk vision with a defined risk appetite and program standards specific to Credit Risk Management.
- **Internal Audit (IAS) –** improves PC Bank's operations by providing independent assurance on the control environment, by using a risk based audit approach.

TABLE 2/3– CAPITAL STRUCTURE AND ADEQUACY

QUALITATIVE DISCLOSURES

Gross Tier I Capital

The capital structure of PC Bank consists of the following which combine to form PC Bank's Gross Tier I Capital:

- Common Shares;
- Retained Earnings; and
- Contributed Surplus

The Company is a wholly owned subsidiary of Loblaw Companies Limited. The Company has authorized an unlimited number of common shares without par value. As at September 30, 2012, PC Bank had 42,002 common shares issued and outstanding.

QUANTITATIVE DISCLOSURES

Total Capital	Dec 31, 2011	Mar 31, 2012	June 30, 2012	Sep 30, 2012
Common Share	42,002	42,002	42,002	42,002
Retained Earnings	327,423	344,180	360,426	384,610
Contributed Surplus	5,410	5,410	5,410	5,410
Gross tier 1 capital	374,835	391,592	407,838	432,022
Net Tier 1 Capital (A)	374,835	391,592	407,838	432,022
Total Capital (B)	**374,835**	**391,592**	**407,838**	**432,022**

Risk Weighted Assets Calculation (Standard Approach)	**Dec 31, 2011**	**Mar 31, 2012**	**June 30, 2012**	**Sep 30, 2012**
Credit Risk				
Deposits with Regulated Financial Institutions	56,592	102,399	66,923	45,163
Risk Weighted - Deposits with Regulated Financial Institutions	11,318	20,480	13,385	9,033
Government Treasury Bills	26,997	119,827	29,957	48,995
Risk Weighted - Government Treasury Bills	-	-	-	-
Credit Card Loans	620,714	489,401	608,502	663,869
Risk Weighted - Credit Card Loans	471,559	371,483	461,189	504,167
Other Assets	89,270	80,303	75,370	76,614
Risk Weighted - Other Assets	89,270	80,303	75,370	76,614
Total Risk Weighted Assets for Credit Risk	572,147	472,266	549,944	589,814
Operational Risk				
Average three-year gross income	492,907	497,564	501,679	505,415
Total Risk Weighted assets for Operational Risk	924,200	932,938	940,650	947,650
Total Risk Weighted Assets (C)	**1,496,347**	**1,405,204**	**1,490,594**	**1,537,464**
Capital Ratio				
Tier 1 Capital Ratio - min. 7% (A/C)	**25.05%**	**27.87%**	**27.36%**	**28.10%**
Total Capital Ratio - min. 10% (B/C)	**25.05%**	**27.87%**	**27.36%**	**28.10%**
Assets to Capital Multiple				
Notional Assets less Allowance for credit card losses	756,775	756,061	744,030	794,340
Securitized Assets	1,505,000	1,505,000	1,505,000	1,505,000

Net on-balance sheet assets (D)	2,261,775	2,261,061	2,249,030	2,299,340
Total Capital (B)	374,835	391,592	407,838	432,022
Assets to capital multiple (D/B)	**6.03**	**5.77**	**5.51**	**5.32**

TABLE 4 / 5 – CREDIT RISK

QUALITATIVE DISCLOSURES

The Credit risk associated with PC Bank's credit card portfolio is defined as the risk of financial loss resulting from the failure of a debtor, for any reason, to fully honour its financial or contractual obligations.

Through the credit card portfolio, PC Bank acts as an unsecured lender with the objective of managing a portfolio of receivables within the Board approved credit risk appetite and in accordance with the Credit Risk Management & Fraud Policy.

Within the credit card portfolio, PC Bank is exposed to credit risk through:

- Acquisition strategies and/or practices for new accounts; and
- Account management strategies and/or practices for established accounts.

Allowance for Credit Card Losses

The measurement of the allowance for credit card losses is contained within the Board of Directors' approved Allowance for Credit Risk policy. The allowance for credit card losses is established for impaired loans on the PC Bank's loan portfolio when a loss event has occurred. Objective evidence used to identify impaired loans is the cardholder entering into bankruptcy and/or defaulting/becoming delinquent on their loan obligation. Key portfolio performance metrics which impact the loan loss amount, such as monthly write-off rates as a percentage of average receivables and delinquency measures, as well as key macro-economic data are used in assessing the adequacy of the allowance for credit card losses. The allowance for credit card losses is reviewed and recommended by the Chief Risk Officer and the Chief Financial Officer to the Board of Directors for ultimate approval.

For accounting purposes, credit card loans are stated at their amortized cost, which is net of an allowance for credit card losses. Any credit card loan with a payment that is contractually 180 days in arrears, or where likelihood of collection is considered remote, is written off.

QUANTITATIVE DISCLOSURES

The following information provides quantitative analysis of PC Bank's total credit card portfolio by account balance, credit limit, delinquency and geography.

	Total Accounts			
Account Balances	Number of Accounts	Percentage of Total Accounts	Receivables Outstanding	Percentage of Total Receivables
Credit Balance	131,092	4.43%	-$ 13,211,070	-0.61%
No Balance	1,483,156	50.17%	$ -	0.00%
< or equal $500.00	514,347	17.40%	$ 102,720,623	4.74%
$500.01 to $1000.00	240,211	8.12%	$ 178,634,546	8.23%
$1,000.01 to $3,000.00	379,001	12.82%	$ 680,103,835	31.35%
$3,000.01 to $5,000.00	114,299	3.87%	$ 440,439,700	20.30%
$5,000.01 to $10,000.00	74,326	2.51%	$ 505,694,360	23.31%
> $10,000.00	20,067	0.68%	$ 274,850,705	12.67%
Totals	2,956,499	100.00%	$ 2,169,232,699	100.00%

	Total Accounts			
Credit Limits	Number of Accounts	Percentage of Total Accounts	Receivables Outstanding	Percentage of Total Receivables
< or equal $500	347,270	11.75%	$ 13,996,212	0.65%
$500.01 to $1000.00	367,978	12.45%	$ 68,446,689	3.16%
$1,000.01 to $3,000.00	740,923	25.06%	$ 350,080,068	16.14%
$3,000.01 to $5,000.00	471,798	15.96%	$ 329,081,902	15.17%
$5,000.01 to $10,000.00	620,492	20.99%	$ 625,957,313	28.86%
> $10,000.00	408,038	13.80%	$ 781,670,515	36.03%
Totals	2,956,499	100.00%	$ 2,169,232,699	100.00%

	Total Accounts				
Days Delinquent	Number of Accounts	Percentage of Total Accounts	Receivables Outstanding		Percentage of Total Receivables
Zero Balance	905,281	30.62%	$	-	0.00%
Transfers	588,227	19.90%	$	1,451,362	0.07%
Credit Balance	127,004	4.30%	-$	12,114,024	-0.56%
Current	1,251,151	42.32%	$	2,052,078,672	94.60%
1 day to 29 days	49,668	1.68%	$	78,354,357	3.61%
30 days to 59 days	12,741	0.43%	$	17,117,839	0.79%
60 days to 89 days	7,659	0.26%	$	10,657,416	0.49%
90 days to 119 days	6,115	0.21%	$	8,556,857	0.39%
120 days to 149 days	4,907	0.17%	$	7,198,779	0.33%
150 days to 179 days	3,746	0.13%	$	5,931,442	0.27%
Totals	2,956,499	100.00%	$	2,169,232,699	100.00%

	Total Accounts				
Province	Number of Accounts	Percentage of Total Accounts	Receivables Outstanding		Percentage of Total Receivables
AB	305,039	10.32%	$	257,604,090	11.88%
BC	368,997	12.48%	$	260,739,429	12.02%
MB	125,367	4.24%	$	100,411,474	4.63%
NB	47,388	1.60%	$	34,730,532	1.60%
NL	22,564	0.76%	$	16,653,688	0.77%
NS	80,799	2.73%	$	65,697,117	3.03%
NT	1,128	0.04%	$	728,883	0.03%
NU	241	0.01%	$	148,188	0.01%
ON	1,520,116	51.42%	$	1,182,534,605	54.51%
PE	8,805	0.30%	$	7,503,669	0.35%
QC	400,272	13.54%	$	181,561,076	8.37%
SK	70,569	2.39%	$	58,349,625	2.69%
YT	2,033	0.07%	$	1,514,966	0.07%
Other	3,181	0.11%	$	1,055,355	0.05%
Totals	2,956,499	100.00%	$	2,169,232,699	100.00%

Allowance for Credit Card Losses:

The following are the changes in the allowance for credit card losses for the 9 months ended September 30, 2012:

Allowance for Credit Card Losses, beginning of year	$	36,798
Provision for credit card losses		71,639
Recoveries		8,861
Write-offs		(76,997)
Allowance for Credit Card Losses, September 30, 2012	$	40,301

TABLE 8 – GENERAL DISCLOSURE FOR EXPOSURES RELATED TO COUNTERPARTY CREDIT RISK

PC Bank conservatively manages its counterparty credit risk exposures by setting internal limits on total exposure, tenor and ratings for each of the counterparties.

QUANTITATIVE DISCLOSURES

		Dec 31, 2011		Mar 31, 2012		June 30, 2012		Sep 30, 2012
Deposits with Regulated Financial Institutions	$	56,592	$	102,399	$	66,923	$	45,163
Government of Canada Treasury Bills	$	26,997	$	119,827	$	29,957	$	48,995

TABLE 9 – SECURITIZATION: Disclosure for standardized and IRB Approaches

QUALITATIVE DISCLOSURES:

Securitization Risk is defined as the inability to secure suitable securitization arrangements for funding purposes and PC Bank's failure to meet the securitization covenant requirements. PC Bank acts as the originator and sponsor of its securitization program. PC Bank does not invest in asset backed securities or provide liquidity facilities for asset backed commercial paper.

PC Bank is dependent on its securitization program to fund a large portion of its credit card receivables. The securitization program includes following two key channels.

- Term Notes issued by Eagle Credit Card Trust. During 2010, Eagle Credit Card Trust issued $250 million of 2.88% medium term notes due in 2013 and $350 million of 3.58% medium term notes due in 2015.
- Asset Back Commercial Paper issued by Other Independent Securitization Trusts at variable rates which mature by 2014.

QUANTITATIVE ANALYSIS:

	Dec 31, 2011	Mar 31, 2012	June 30, 2012	Sep 30, 2012
Credit card receivables	$ 2,089	$ 1,959	$ 2,077	**2,129**
Securitized to *Eagle Credit Card Trust*	$ 600	$ 600	$ 600	**$ 600**
Securitized to Other Independent Securitization Trusts	$ 905	$ 905	$ 905	**$ 905**

TABLE 12 – OPERATIONAL RISK

Operational risk is defined as the risk of direct or indirect loss resulting from inadequate or failed internal processes, people and systems or from external events. Key operational risks considered include Partnering/Outsourcing, Business Interruption, Information Security, Regulatory, Litigation, and Strategic & Execution. PC Bank's ERMC is responsible for the oversight of operational risk, with assistance from various internal business groups and internal control and compliance teams. The ERMC maintains certain thresholds for compliance for each of the risks, and monitors these thresholds on a monthly basis to ensure compliance.

PC Bank uses the basic indicator approach to measure operational risk. Operational risk is calculated as shown in TABLE 2/3 – Capital Structure and Adequacy.

TABLE 14 – INTEREST RATE RISK IN THE BANKING BOOK

Interest Rate Risk is defined as the risk of loss resulting from changes in interest rates or in the volatility of interest rates; this includes the rising cost of funds and lower margins experienced as interest rates rise.

To mitigate this risk, the Bank undertakes the following mitigation steps:

- The Asset Liability Management Policy is the key Board policy that governs Interest Rate risk at PC Bank. Key principles of Asset Liability Management Policy are:
  - Preserving the long-term value of the spread income generated by its business, regardless of changes in interest rates
  - Managing asset and liability cash flows in a way that maximizes earnings within approved risk appetite levels;

- Management is responsible for monitoring, managing and reporting interest rate risk in accordance with Board approved policies. ALCO (Asset Liability Committee) meets on a monthly basis and reviews the cost of funds by channel, the funding plan, the fixed floating mix and on a quarterly basis reviews the sensitivity of Net Interest Income of PC Bank and regulatory capital to parallel and non parallel movement in interest rates. ALCO reports to the Audit Committee of the Board on a quarterly basis. On an annual basis, the Audit Committee of the Board approves the Interest Rate Risk Management plan.

- Limit Structure - PC Bank monitors the following limits to ensure adherence to the above listed policies

  Fixed Floating Mix

  - REQUIREMENT: An adequate mix of fixed and floating-rate instruments serves to ensure diversification of interest rate exposure. The acceptable range for both the "fixed" and "floating" portions of the mix is set to be between 40% and 60%; neither to exceed 60%. The target fixed floating mix is set at 40% fixed and 60% floating.
  - TEST: As at September 30, 2012, PC Bank had 54% of the liabilities that were floating in nature and 46% fixed in nature.

  Net Interest Income ("NII") Sensitivity

  - REQUIREMENT: For 200 bps adverse parallel movement in interest rates, impact not more than 15% of 12-month forward Net Interest Income.
  - TEST: As of September 30, 2012, Net Interest Income sensitivity ratio of PC Bank was 8.1% for a 200 bps adverse movement in interest rates.

  Market Value Sensitivity

  - REQUIREMENT: For 200 bps parallel movement the impact on regulatory capital is not more than 20%
  - TEST: As of September 30, 2012, Market Value sensitivity of PC Bank was 6.4% for a 200 bps adverse movement in interest rates.