



President's Choice Bank

BASEL III PILLAR 3 DISCLOSURES

September 30, 2013

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TABLE 1 – OVERVIEW & SCOPE OF APPLICATION

This document represents the Basel III 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, and OSFI’s Basel III Pillar 3 requirements Advisory issued in July 2013. Basel III, issued in June 2011, is part of the Basel Committee’s continuous effort to enhance the banking regulatory framework. It builds on the International Convergence of Capital Measurement and Capital Standards document (Basel II). Basel III 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.

OSFI requires all institutions to implement the Basel III framework, and the new composition of capital disclosure requirements. This document presents capital structure and adequacy calculations based on Basel III guidelines on both an “All-in” basis (after the transition period for the phasing-in of deductions ends on January 1, 2018) and a “Transitional” basis (before January 1, 2018) as per OSFI requirement.

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 who reside 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 ERM to ensure that PC Bank stays within its 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)** – assists the Risk Committee of the Board in
 - Overseeing PC Bank’s risk management activities by providing strategic direction on the management of liquidity risk, interest rate risk, investment risk, and other aspects of Asset Liability Management;
 - 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; and
 - Proactively assessing the balance sheet dynamics, having regard to economic data and forecasts, PC Bank’s legal structure, market developments, accounting pronouncements, etc.
 - **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 and Fraud Management Committee (CRFMC)** – has the following key responsibilities:
 - Providing a governance structure that oversees the Credit Risk Management program, including the associated strategies, policies and procedures;
 - Ensuring that Credit Risk and Fraud Risk forecasts are appropriate giving consideration to PC Bank’s strategic directions, risk profile and appetite, emerging risks and stress tests;
 - Providing guidance on the methodology to continually identify, define, assess, manage, and report Credit Risk and Fraud Risk exposure.
 - **Internal Audit (IAS)** – assists Management in accomplishing its objectives by bringing a systematic and disciplined approach to evaluate and improve the effectiveness of PC Bank’s risk management, control and governance processes.
 - **Anti-Money Laundering and Anti-Terrorist Financing Committee (AML/ATF)** – provides a governance structure that oversees PC Bank’s AML/ATF program, guiding the development of a methodology and tools to identify, define, assess, manage, control, measure, monitor, and report AML/ATF risks, while mitigating AML/ATF risks in accordance with PC Bank’s established risk appetite.

TABLE 2/3– CAPITAL STRUCTURE AND ADEQUACY

QUALITATIVE DISCLOSURES

Gross Common Equity Tier I Capital

The capital structure of PC Bank consists of the following which combine to form PC Bank’s Gross Common Equity 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, 2013, PC Bank had 42,002 common shares issued and outstanding.

QUANTITATIVE DISCLOSURES

Total Capital

		September 30, 2013	
		All-in	Transitional
1	Common Share plus Contributed Surplus	47,412	
2	Retained Earnings	516,934	
6	Gross Common Equity Tier 1 capital per Basel III	564,346	
28	Regulatory Adjustments Applied to Common Equity Tier 1 per Basel III	(1,686)	
29	Common Equity Tier 1 Capital (CET1) (A)	562,660	564,346
44	Additional Tier 1 capital (AT1)	-	
45	Total Tier 1 capital (B)	562,660	564,346
59	Total Capital (C)	562,660	564,346

Risk Weighted Assets Calculation (Standard Approach)

		September 30, 2013	
		All-in	Transitional
Credit Risk			
60	Total Risk Weighted Assets (D)	1,902,260	1,903,946

Capital Ratio

61	Common Equity Tier 1 Capital Ratio per Basel III (A/D)	29.58%	29.64%
62	Tier 1 Capital Ratio (B/D)	29.58%	29.64%
63	Total Capital Ratio (C/D)	29.58%	29.64%

OSFI All-in Target

69	Common Equity Tier 1 capital OSFI all-in target ratio	7%
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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 VP, Credit Risk 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.

Account Balances	Total Accounts			
	Number of Accounts	Percentage of Total Accounts	Receivables Outstanding	Percentage of Total Receivables
Credit Balance	148,327	4.03%	\$ (13,924,077)	-0.57%
No Balance	2,085,176	56.60%	\$ -	0.00%
LT or equal \$500.00	540,242	14.66%	\$ 110,640,632	4.49%
\$500.01 to \$1000.00	258,194	7.01%	\$ 192,009,227	7.80%
\$1,000.01 to \$3,000.00	408,225	11.08%	\$ 738,703,206	30.00%
\$3,000.01 to \$5,000.00	133,320	3.62%	\$ 514,102,027	20.88%
\$5,000.01 to \$10,000.00	86,332	2.34%	\$ 585,686,665	23.79%
GT \$10,000.00	24,189	0.66%	\$ 334,753,325	13.61%
Totals	3,684,005	100.00%	\$ 2,461,971,005	100.00%

Credit Limits	Total Accounts			
	Number of Accounts	Percentage of Total Accounts	Receivables Outstanding	Percentage of Total Receivables
LT or equal \$500	377,640	10.25%	\$ 15,324,095	0.62%
\$500.01 to \$1000.00	508,745	13.81%	\$ 79,005,037	3.21%
\$1,000.01 to \$3,000.00	976,407	26.50%	\$ 386,917,363	15.72%
\$3,000.01 to \$5,000.00	596,837	16.20%	\$ 397,994,997	16.17%
\$5,000.01 to \$10,000.00	742,949	20.17%	\$ 703,447,811	28.57%
GT \$10,000.00	481,427	13.07%	\$ 879,281,702	35.71%
Totals	3,684,005	100.00%	\$ 2,461,971,005	100.00%

Days Delinquent	Total Accounts			
	Number of Accounts	Percentage of Total Accounts	Receivables Outstanding	Percentage of Total Receivables
Current ⁽¹⁾	3,599,016	97.69%	\$ 2,311,021,139	93.87%
1 day to 29 days	52,517	1.43%	\$ 94,457,293	3.84%
30 days to 59 days	11,817	0.32%	\$ 19,779,223	0.80%
60 days to 89 days	7,119	0.19%	\$ 12,083,020	0.49%
90 days to 119 days	5,319	0.14%	\$ 9,506,045	0.39%
120 days to 149 days	4,608	0.13%	\$ 8,127,488	0.33%
150 days to 179 days	3,596	0.10%	\$ 6,938,033	0.28%
180+ days	13	0.00%	\$ 58,764	0.00%
Totals	3,684,005	100.00%	\$ 2,461,971,005	100.00%

Note 1: Current category includes zero balance, credit balance, and transfers accounts.

Province	Total Accounts			
	Number of Accounts	Percentage of Total Accounts	Receivables Outstanding	Percentage of Total Receivables
AB	388,045	10.53%	\$ 306,716,068	12.46%
BC	475,195	12.90%	\$ 302,135,050	12.27%
MB	152,181	4.13%	\$ 116,438,892	4.73%
NB	56,510	1.53%	\$ 37,554,074	1.53%
NL	24,903	0.68%	\$ 17,302,508	0.70%
NS	104,095	2.83%	\$ 72,624,666	2.95%
NT	1,413	0.04%	\$ 905,775	0.04%
NU	301	0.01%	\$ 164,428	0.01%
ON	1,896,778	51.48%	\$ 1,322,222,201	53.70%
PE	11,704	0.32%	\$ 8,236,565	0.33%
QC	480,137	13.03%	\$ 205,252,901	8.34%
SK	85,388	2.32%	\$ 68,926,393	2.80%
YT	3,448	0.09%	\$ 2,387,240	0.10%
Other	3,907	0.11%	\$ 1,104,244	0.04%
Totals	3,684,005	100.00%	\$ 2,461,971,005	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, 2013:

Allowance for Credit Card Losses, beginning of year	\$ 42,736
Provision for credit card losses	75,728
Recoveries	10,387
Write-offs	<u>(83,924)</u>
Allowance for Credit Card Losses, September 30, 2013	<u>\$ 44,927</u>

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

	<u>Sep 30, 2013</u>
Deposits with Regulated Financial Institutions	\$ 19,765
Government Treasury Bills	\$ 24,996

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 2015.

QUANTITATIVE ANALYSIS:

(In Millions of Canadian Dollars)

	<u>Sep 30, 2013</u>
Credit card receivables	\$ 2,417
Securitized to Eagle Credit Card Trust	\$ 600
Securitized to Other Independent Securitization Trusts	\$ 905

	DBRS Limited Ratings	Moody's Investors Services, Inc Ratings
Eagle Series 2010-1 Class A Notes	AAA (sf)	Aaa (sf)
Eagle Series 2010-1 Class B Notes	A (sf)	A2 (sf)
Eagle Series 2010-1 Class C Notes	BBB (sf)	Baa2 (sf)
Eagle Series 2010-2 Class A Notes	AAA (sf)	Aaa (sf)
Eagle Series 2010-2 Class B Notes	A (sf)	A2 (sf)
Eagle Series 2010-2 Class C Notes	BBB (sf)	Baa2 (sf)

Subsequent to the third quarter of 2013, Eagle Credit Card Trust issued \$400 million of senior and subordinate term notes with a maturity date of October 17, 2018 at a weighted average interest rate of 2.91%.

On December 17, 2013, the three-year \$250 million senior and subordinated term notes issued by Eagle will mature. In conjunction with this upcoming maturity, the Company accumulated \$83 million of cash in September, 2013. Subsequent to the third quarter of 2013, the Company accumulated a further \$83 million by the end of October and will continue to accumulate an additional \$83 million by the end of November 2013.

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 ERM is responsible for the oversight of operational risk, with assistance from various internal business groups and internal control and compliance teams. The ERM 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.

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.
- As of September 30, 2013, PC Bank had 45% of the liabilities that were floating in nature and 55% 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.
- As of September 30, 2013, Net Interest Income sensitivity ratio of PC Bank was 7.2% 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%
- As of September 30, 2013, Market Value sensitivity of PC Bank was 5.6% for a 200 bps adverse movement in interest rates.

LIQUIDITY RISK

PC Bank’s approach to managing liquidity risk

Liquidity refers to the capacity of PC Bank to generate or obtain sufficient cash or its equivalent in a timely manner at a reasonable price to meet its commitments as they fall due and to fund new business opportunities as part of going-concern operations. Liquidity risk is the potential for losses to be incurred from holding insufficient liquidity to survive a contingent stress event.

PC Bank maintains a stock of high-quality unencumbered liquid assets (“liquid assets”) sufficient to meet its operational needs as well as expected and unexpected outflows. The amount of liquid assets is directly linked to operational requirements, stock and maturity profile of GIC’s and other maturing liabilities. Liquid assets are also monitored daily and supported by a range of early warning indicators. As at September 30, 2013 liquid assets were \$45M.

PC Bank has a comprehensive liquidity risk framework guided by:

- Board approved policies reviewed at least annually;
 - Board approved funding plan that provides effective diversification in the sources and tenor of funding;
 - Sensitivity analysis and stress testing on a regular basis for a variety of scenarios; and
 - Ensuring Treasury operations are supported by appropriate expertise and capabilities.
-