Office of the Superintendent of Financial Institutions Canada
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255, rue Albert
Ottawa, Canada
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www.osfi-bsif.gc.ca

August 21, 2002

Mr. Purdy Crawford
Chair
Five-Year Review Committee
Osler, Hoskin & Harcourt, LLP
P.O. Box 50
1 First Canadian Place
Toronto, Ontario
M5X 1B8

Dear Mr Crawford:

I am writing to follow up on our meeting concerning the recommendations in the Report of the Five-Year Review Committee concerning the so-called GAAP override provision and its interaction with securities regulation. I believe that the report's recommendation is based on an outdated incomplete understanding of OSFI's position. I also believe that it is possible to accommodate the legitimate interests of prudential regulators and securities regulators.

In particular, the Report rests its conclusions on the need for adequate and full and prompt disclosure to investors, and the fact that good accounting standards are a necessary precondition for sound market regulation. I agree.

The Report uses as examples the situation in which the Office used its powers as part of an effort to enhance the loan loss reserves of major banking institutions. This is the only case that I am aware of use of the provision.

The Office engaged in that effort because we believed that it was important for safety and soundness reasons, because we believed that current GAAP did not adequately account for loan losses inherent in portfolios, and after a considerable (but unsuccessful) attempt to get the accounting standards setters to reconsider the issue. Subsequent events have shown that our position was correct. It is only now that international accounting standards setters are coming to recognize that the model being used for loan loss accounting has flaws. In part, in developing our policy we also noted that U.S. GAAP appeared to contain flexibility so that U.S. banking organizations comparable to those in Canada had considerably higher loan loss allowances.

Throughout all of this effort OSFI consistently promoted full disclosure by institutions affected of the impact of our actions, and that occurred. We also made it clear to affected institutions that the requirements of securities regulators with respect to disclosure had to be met. Indeed the audit standards in the case of use of the override require that it be disclosed.

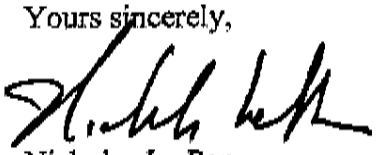
I would also note that the auditing requirements of the CICA that apply when the override power is used (which OSFI helped develop a number of years ago) require that the auditor consider whether the impact results in the statements being misleading, and if so to so indicate in expressing a reservation to the audit opinion. I believe it is important that there are a number of checks and balances in the system.

I believe that the override power is an important part of the prudential regulatory system and the ability to use it in cases of potentially important issues should not be eroded. Accordingly I disagree with the Report's conclusion. Moreover I believe that a simple change to the relevant regulation in Ontario could ensure that the legitimate needs of various parties could be fully accommodated in the rare cases where the override power is used. In particular regulations could be altered to continue to recognize the override provisions but to make that recognition conditional on securities regulators being satisfied with the disclosure of the impact of use of the provision.

At our meeting, the question was raised about the continued relevance of the override given the fact that a number of major regulated financial institutions are also U.S. registrants. I noted that far from all federally regulated FIs are or will be in that category.

Also, even if a firm were a U.S. registrant, it would be wrong in my view to use that factor as a reason to eliminate recognition of the override in Ontario regulations. Rather that is a factor that all concerned would have to take into account in its application.

Yours sincerely,



Nicholas Le Pan
Superintendent

c.c. Mr. David Brown
Chair
Ontario Securities Commission

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Please see attached document (original to follow by mail).

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August 29, 2002

Mr. Purdy Crawford
Chair
Five-Year Review Committee
Osler, Hoskin & Harcourt, LLP
P.O. Box 50
1 First Canadian Place
Toronto, ON M5X 1B8

Dear Mr. Crawford:

You asked for my views on the submission of the CICA with respect to the GAAP override.

The essence of the position of the CICA is expressed in its letter to you of August 19, 2002, commenting on the Review Committee Report. It notes that "external stakeholders are not best served by financial statements that depart from GAAP". It also notes that "It is not necessary to override GAAP because financial institution regulators can obtain the additional or adjusted financial information they need to make decisions on capital adequacy through requiring separate reports to them".

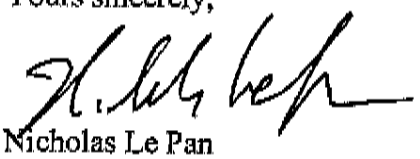
As I explained in my previous letter to you, there may be a few rare times when OSFI is of the view that it is essential certain items be treated in a particular way for institutions' public statements. These should be extremely rare and disclosed publicly. I believe that was the intent of Parliament in enacting the provision in the first place. The Parliamentary committee that recently considered the CICA's submission on the same issue in the case of the recently enacted holding company legislation also reached the same conclusion. I believe it would be undesirable for securities regulation to undercut this particularly when an option is available to meet the legitimate needs of both, as outlined in my previous letter.

As I also noted in my previous letter in the sole significant case where OSFI used this power, with respect to loan losses, OSFI had previously tried to have standard setters address what OSFI viewed as material deficiencies in the accounting treatment for loan losses.

The CICA position quoted above rests on the view that the only purpose of the Superintendent's override would be to better align financial statement reporting with capital requirements. However, it is not.

The override provision was put in place to cover the hopefully extremely rare situations in which the Superintendent believed that the financial statements of regulated institutions were not fairly representing their condition in a serious enough way to justify overriding GAAP. The case of general allowances is a case in point in which the Office believed that the current accounting for provisions was not producing adequate results. In that case, as set out in my earlier letter, I believe a far better policy result was for the Office to exercise its override and for the effect of that to be disclosed to investors. I also believe that subsequent events have shown that the Office's view had merit. Merely requiring institutions to hold more capital would not have resulted in adequate measurement of earnings in a number of cases nor in adequate measurement of the extent of provisions for credit losses.

Yours sincerely,



Nicholas Le Pan
Superintendent

c.c. Mr. David Brown, Chair, Ontario Securities Commission
Mr. David Smith, President & CEO, Canadian Institute of Chartered Accountants