



**BASEL III PILLAR 3 DISCLOSURES**

**December 31, 2015**

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**HomEquity Bank**  
**Basel III Pillar 3 Disclosures**  
**December 31, 2015**

**Table 1. Scope of application**

HomEquity Bank (the Bank) is a federally regulated Schedule I bank, incorporated and domiciled in Canada. The Bank's main business is to originate and administer reverse mortgages. The Bank also issues guaranteed investment certificates and through its principal subsidiary, medium-term debt to fund its mortgage portfolio. The Bank is a wholly owned subsidiary of HOMEQ Corporation (HOMEQ), a private company. HOMEQ is wholly owned by Birch Hill Equity Partners Management Inc., which is the ultimate parent of the Bank. The Bank's principal subsidiary is CHIP Mortgage Trust. All of the Bank's subsidiaries are directly or indirectly wholly owned.

**Basis of preparation**

This document represents the Basel III Pillar 3 disclosure for the Bank. These disclosures are made pursuant to the Office of the Superintendent of Financial Institutions (OSFI) requirements, which are based on global standards established by the Bank of International Settlements, Basel Committee on Banking Supervision (BCBS).

The amounts disclosed in this document are based on the Bank's annual and interim consolidated financial statements, which reflect the financial position and results of operations of the Bank consolidated with the financial position and results of operations of its subsidiaries. The annual consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB), including the accounting requirements specified by the OSFI, and reflect, where necessary, management's best estimates and judgments. This report is unaudited.

**Risk Management**

The Board of Directors (Board) has developed and approved a Capital Management Policy (CMP) in accordance with the Board-approved Risk Appetite Framework (RAF). The Policy addresses minimum regulatory capital requirements as prescribed by regulators and internal capital targets as per the Board-approved RAF, which allows for the appropriate allocation of capital to meet the Bank's strategic goals. The CMP dictates that capital be adequately maintained by the Bank.

Adherence to the CMP ensures that the Bank has sufficient capital to maintain its operations based on current activities, expected future business developments and the possibility of various disruptive or adverse scenarios based on the Bank's stress testing program. Such stress testing scenarios include periods of economic downturn and/or asset re-pricing. In addition, in accordance with the Bank's annual strategic planning, a 3-year forecast is prepared and provides guidance as to the type and extent of capital that will be required over this period of time.

The Bank's Asset Liability Committee (ALCO) ensures adherence to the policy on at least a monthly basis and the Conduct Review and Risk Management Committee (CRRMC) of the Board ensures capital management in accordance with the Policy. The CRRMC meets at least three times a year.

**Table 1. Scope of application (continued)**

The Bank uses the annual Internal Capital Adequacy Assessment Process (ICAAP) to determine the quantity and quality of capital to conduct its business activities. In preparing the ICAAP, the high risk areas established in the Enterprise Risk Management Framework (ERMF) are subject to stress testing which incorporates assumptions established in the annual strategic planning process. The results of the stress tests help to determine the quantum of capital required to enable management and the Board to set capital levels appropriate with the Board-approved RAF.

The Bank's CRRMC is responsible for overseeing the types of risk to which the Bank may be exposed and of the techniques and systems used to identify, measure, monitor, report on and mitigate those risks. It is also responsible for reviewing capital management plans recommended by Management. The Bank's stress testing program is reviewed with the CRRMC by Management at least three times a year. The ICAAP is reviewed by the CRRMC and approved by the Board based on the timeframe set by OSFI.

**Corporate Governance**

The Bank maintains a rigorous corporate governance structure as follows:

- Board of Directors' Oversight
- Conduct Review and Risk Management Committee
- Audit Committee
- Corporate Governance and Compensation Committee

The Bank also has independent oversight functions which include a Chief Risk Officer, a Chief Compliance Officer and a Chief Anti-Money Laundering Officer that report directly to the CEO and the CRRMC. The Board seeks to achieve long-term sustainable risk adjusted growth in order to ensure the health of the Bank and the stability of earnings while protecting the Bank's well respected brand name and reputation and the interests of its depositors, customers and investors.

**Auditor Assessment**

At least annually, the Audit Committee evaluates the performance, qualifications, skills, resources, and independence of the external auditor, including the lead partner, in order to support the Board of Directors in reaching its recommendation to appoint the external auditor. This evaluation includes an assessment of audit quality and service considerations such as: auditor independence, objectivity and professional skepticism; quality of the engagement team; and, quality of the communication and service provided by the external auditor. In the evaluation, the Audit Committee considers the nature and extent of communications received from the external auditor during the year and the responses from management and the Audit Committee to a questionnaire regarding the performance of, and interactions with, the external auditor. Ernst and Young LLP has been appointed as the independent external auditor for the year ended December 31, 2015, in accordance with the recommendation by the Audit Committee.

**Table 1. Scope of application (continued)**

**Business risks**

As a result of the Bank's business model and the terms and conditions of a reverse mortgage, the most material risks faced by the Bank are described below:

**Funding and Liquidity Risk**

Funding and liquidity risk can occur as a result of the uncertain timing of reverse mortgage cash flows and the Bank's reliance on raising funds by the issuance of guaranteed investment certificates and medium-term notes. The Bank has a diversified range of funding sources and has created policies and procedures to ensure that cash flows are accurately predicted and monitored. It also maintains a sufficient amount of liquid assets to fund its anticipated loan commitments, operations, deposit maturities and interest payments should a shortfall arise.

**Interest Rate Risk**

The Bank's operating margin is primarily derived from the spread between interest earned on the mortgage portfolio, and the interest paid on the debt and deposits used to fund the portfolio. Risk arises from the Bank's assets and liabilities having mismatched re-pricing dates, or being referenced to different underlying instruments. The Bank has adopted hedging practices to maintain a relatively stable spread between interest earned on the mortgages and interest paid on the highly rated debt used to fund them.

**Operational Risk**

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. It is the chance of unexpected income losses or increased costs that may emerge as a consequence of human, process or system failure and due to external developments. Operational risk includes legal risk and information technology risk, including cybersecurity risk.

**Regulatory Compliance Risk**

Regulatory risk arises from a financial institution's non-compliance with applicable laws, rules, regulations and prescribed standards in any jurisdiction in which the institution operates. The Bank addresses regulatory requirements in a timely manner to ensure it is compliant with new applicable regulations. The Compliance Department keep the Management team and the Board of Directors (the Board) informed of new regulations, guidelines and changes to existing regulatory requirements.

**Table 1. Scope of application (continued)**

**Reputational Risk**

Management is aware of the potential negative effects of media and reputation risk exposure. The Bank has implemented complaint and incident resolution processes to mitigate these potential risks.

**Strategic Risk**

The Bank is Canada's only national underwriter of reverse mortgages, however there are companies in Canada that offer other alternative products that may compete with the Bank. It is also possible that at some time in the future, banks, other financial services companies or foreign held reverse mortgage providers may decide to enter the market in direct competition to the Bank. The Bank believes that it has established a defensible competitive advantage as a result of its low cost funding, proprietary data, internally developed systems and its established brand recognition and marketing network.

**Underwriting risk**

Provided the homeowner is not in default, the right of the Bank to receive principal and interest when due under the reverse mortgage is limited to the realized value of the property. Underwriting risk is the potential for financial loss if the assets as currently reflected on the Bank's balance sheet become impaired and not fully recoverable. In particular, this can result from a significant and persistent drop in real estate values and/or customers choosing not to repay their mortgages for an extended period of time. The Bank has developed reverse mortgage underwriting criteria which provide reasonable loan to value ratios for the homeowner while seeking to provide assurance that the value of the related property upon maturity will be sufficient to repay the reverse mortgage.

**Table 2/3. Capital Structure and Capital Adequacy**

**Objectives, policies and processes**

The overall objective of capital management is to ensure that the Bank has sufficient capital to maintain its operations based on current activities and expected business developments in the future and to provide a return to its shareholder commensurate with the risk of the business. The Bank's capital resources consist of equity and unsecured subordinated debt.

The Bank's regulatory capital requirements are specified by OSFI guidelines. These requirements are consistent with the framework of risk based capital standards developed by the BCBS and are referred to as Basel III. The Bank adopted certain Basel III capital requirements, as required by OSFI, beginning January 1, 2013. The transitional basis allows for the transition of certain capital deductions over a period ending January 1, 2018, whereas the all-in basis includes all applicable deductions immediately. Amounts not yet deducted from capital under OSFI's transitional rules are risk weighted, creating a difference between risk-weighted assets on a transitional and on an all-in basis.

The primary impact of adoption was the deduction from Common Equity Tier 1 capital on an all-in basis at December 31, 2015 of \$545 (December 31, 2014 - \$480) related to intangible assets which included bank license costs and software, net of deferred taxes. The remaining regulatory adjustment relates to excess mortgage allowances which are applicable to both the all-in and transitional basis.

The Bank has implemented policies and procedures to monitor compliance with regulatory capital requirements. The Bank has implemented an Internal Capital Adequacy Assessment Process which is based on the Bank's assessment of the business risks of the Bank. The Bank's capital structure, risk-weighted assets, capital and leverage ratios, on the all-in and transitional basis are detailed in the tables below:

Table 2/3. Capital structure and Capital Adequacy (continued)

Capital structure

The Bank's internal capital consists of Common Equity Tier 1 and Tier 2 capital. Common Equity Tier 1 capital consists of common shares and deficit reduced by regulatory adjustments. Tier 2 capital consists of subordinated debt in compliance with OSFI Guideline A requirements for Tier 2B limited life instruments. The Bank has authorized an unlimited number of common shares. As at December 31, 2015, the Bank had 113,683 common shares issued and outstanding.

<i>ALL-IN BASIS</i> <i>(in thousands of Canadian dollars)</i>	Dec 31 2014	Mar 31 2015	Jun 30 2015	Sep 30 2015	Dec 31 2015
Common shares	134,261	134,261	134,261	134,261	<b>134,261</b>
Contributed surplus	—	61	117	89	<b>877</b>
Deficit	(14,002)	(11,397)	(8,366)	(4,673)	<b>(1,136)</b>
Accumulated other comprehensive income	(347)	(1,431)	(940)	(849)	<b>(1,182)</b>
Regulatory adjustments (1)	(1,098)	(1,294)	(1,262)	(1,334)	<b>(1,167)</b>
<b>Common Equity Tier 1 capital</b>	<b>118,814</b>	<b>120,200</b>	<b>123,810</b>	<b>127,494</b>	<b>131,653</b>
Book value of unsecured subordinated debt	26,475	20,975	20,975	20,975	<b>20,975</b>
Less: accumulated amortization for capital adequacy	(4,400)	(692)	(692)	(692)	<b>(692)</b>
	22,075	20,283	20,283	20,283	<b>20,283</b>
Eligible collective allowance	3,659	4,022	4,085	4,121	<b>3,854</b>
<b>Tier 2 capital</b>	<b>25,734</b>	<b>24,305</b>	<b>24,368</b>	<b>24,404</b>	<b>24,137</b>
<b>Tier 1 capital and Total regulatory capital</b>	<b>144,548</b>	<b>144,505</b>	<b>148,178</b>	<b>151,898</b>	<b>155,790</b>

(1) Regulatory adjustments on the all-in basis include intangible assets related to bank license costs and software, net of deferred taxes, and excess mortgage allowances.

<i>TRANSITIONAL BASIS</i> <i>(in thousands of Canadian dollars)</i>	Dec 31 2014	Mar 31 2015	Jun 30 2015	Sep 30 2015	Dec 31 2015
All-in Common Equity Tier 1 capital	118,814	120,200	123,810	127,494	<b>131,653</b>
Transitional adjustments		1,184	915	842	<b>1,036</b>
<b>Common Equity Tier 1 capital</b>	<b>119,476</b>	<b>121,384</b>	<b>124,725</b>	<b>128,336</b>	<b>132,689</b>
<b>Tier 2 capital</b>	<b>25,734</b>	<b>24,305</b>	<b>24,368</b>	<b>24,404</b>	<b>24,137</b>
<b>Tier 1 capital and Total regulatory capital</b>	<b>145,210</b>	<b>145,689</b>	<b>149,093</b>	<b>152,740</b>	<b>156,826</b>

Table 2/3. Capital structure and Capital Adequacy (continued)

Risk-weighted assets

The Bank's risk-weighted assets include all on-balance sheet assets weighted for the risk inherent in each type of asset, an operational risk component based on a percentage of average risk-weighted revenues and a market risk component for off-balance sheet derivative financial instruments. The Bank uses the standardized approach for credit risk for all on-balance sheet assets, basic indicator approach for operational risk and the standardized approach for market risk.

The Bank's investment securities may consist of bank debt securities, government and provincial debt securities and corporate debt securities with ratings ranging from R1-low to R1-high and their equivalents. The Bank uses DBRS Limited for determining credit ratings. Investment securities have risk-weightings ranging from 0% to 50% based on their credit rating. Loans receivable, consisting of residential reverse mortgages have a risk-weighting of 35% to 100% with an average risk-weighting of 44.5% at December 31, 2015. All other assets are risk-weighted at 100%.

<i>ALL-IN BASIS Risk-weighted assets (in thousands of Canadian dollars)</i>	Dec 31 2014	Mar 31 2015	Jun 30 2015	Sep 30 2015	Dec 31 2015
Corporate debt securities	795	100	1,319	609	—
Deposits with regulated financial institutions	12,002	13,444	13,839	13,577	<b>30,997</b>
Residential reverse mortgages	765,520	786,638	809,527	831,915	<b>861,173</b>
Other assets	57,952	58,245	59,600	58,631	<b>60,867</b>
	836,269	858,427	884,285	904,732	<b>953,037</b>
Off-balance sheet exposure	1,928	3,681	2,884	3,463	<b>2,921</b>
Credit risk	838,197	862,108	887,169	908,195	<b>955,958</b>
Operational risk (average three-year gross income)	57,258	58,642	60,287	63,599	<b>66,306</b>
<b>Total risk-weighted assets</b>	<b>895,455</b>	<b>920,750</b>	<b>947,456</b>	<b>971,794</b>	<b>1,022,264</b>

<i>TRANSITIONAL BASIS Risk-weighted assets (in thousands of Canadian dollars)</i>	Dec 31 2014	Mar 31 2015	Jun 30 2015	Sep 30 2015	Dec 31 2015
Total risk-weighted assets on all-in basis	895,455	920,750	947,456	971,794	<b>1,022,264</b>
Transitional adjustments	384	326	352	333	<b>327</b>
<b>Total risk-weighted assets on transitional basis</b>	<b>895,839</b>	<b>921,076</b>	<b>947,808</b>	<b>972,127</b>	<b>1,022,591</b>

Table 2/3. Capital structure and Capital Adequacy (continued)

Capital ratios

<i>ALL-IN BASIS</i>	Dec 31 2014	Mar 31 2015	Jun 30 2015	Sep 30 2015	Dec 31 2015
Common Equity Tier 1 ratio (1)	13.3%	13.1%	13.1%	13.1%	<b>12.9%</b>
Tier 1 Capital Ratio (2)	13.3%	13.1%	13.1%	13.1%	<b>12.9%</b>
Total Capital Ratio (3)	16.1%	15.7%	15.6%	15.6%	<b>15.2%</b>
Leverage ratio (4)	—	6.30%	6.30%	6.32%	<b>5.94%</b>

(1) The Common Equity Tier 1 Ratio is defined as Common Equity Tier 1 capital divided by total risk-weighted assets.

(2) The Tier 1 Capital Ratio is defined as Tier 1 capital divided by total risk-weighted assets.

(3) The Total Capital Ratio is defined as total regulatory capital divided by total risk-weighted assets.

(4) The Leverage Ratio is calculated by dividing Tier 1 capital by total exposures, which include on-balance assets and certain derivatives exposure.

<i>TRANSITIONAL BASIS</i>	Dec 31 2014	Mar 31 2015	Jun 30 2015	Sep 30 2015	Dec 31 2015
Common Equity Tier 1 ratio	13.3%	13.2%	13.2%	13.2%	<b>13.0%</b>
Tier 1 Capital Ratio	13.3%	13.2%	13.2%	13.2%	<b>13.0%</b>
Total Capital Ratio	16.2%	15.8%	15.7%	15.7%	<b>15.3%</b>

For purposes of meeting minimum regulatory capital ratios prescribed by OSFI, the all-in basis is required. During the year ended December 31, 2015, the Common Equity Tier 1, Tier 1 and Total Capital ratios remain above OSFI's stated minimum capital ratios of 7%, 8.5% and 10.5%, respectively, for a well-capitalized financial institution. On January 1, 2015, the Basel III Leverage ratio (LR) replaced the previous Asset to Capital Multiple measure. The LR is a non-risk based ratio intended to act as a supplementary measure to the risk-based capital requirements. The Leverage Ratio is calculated by dividing Tier 1 capital by total exposures, which include on-balance sheet assets and certain derivatives exposure. The Bank's LR was also above the minimum assigned to the Bank by OSFI.

**Table 4/5. Credit risk – general disclosures for all banks**

The Bank performs regular monitoring of its risks, assessments, and related action plans. Senior management and the Board of Directors obtain information that allows them to keep informed regarding the effectiveness of their risk management process and activities. The Bank has a Conduct Review and Risk Management Committee to assist the Board in fulfilling its responsibilities.

Credit risk is the potential for financial loss if a borrower or counterparty in a transaction fails to meet its obligations in accordance with agreed terms. Credit risk on the Bank's cash and cash equivalents is mitigated by maintaining cash balances at Schedule I Canadian chartered banks.

Underwriting risk on the mortgage loans is mitigated by following Board-approved underwriting policies. In particular, during the underwriting process, every property is appraised by a certified appraiser with particular attention paid to property type, location and days on market of each comparative property. The initial appraised value is subsequently discounted, typically by between 5% and 30%. A rate of future property appreciation assumed for the life of the mortgage is low in comparison with the Canadian average for the past 20 years. The average rate of assumed appreciation used in the initial underwriting of the existing mortgage portfolio is approximately 0.61%. Each mortgage originated is limited in maximum dollar amount and loan-to-value ratio in accordance with internal guidelines. The Bank also obtains a first charge on the underlying property securing the mortgage. Underwriting risk is mitigated further by the geographic diversity and the collateralization of the portfolio.

**Cash resources and securities**

	Dec 31 2014	Mar 31 2015	Jun 30 2015	Sep 30 2015	Dec 31 2015
<i>(in thousands of Canadian dollars)</i>	\$	\$	\$	\$	\$
Cash and non-interest bearing deposits with banks	16,807	67,218	69,197	36,633	<b>81,329</b>
Bank debt securities	43,205	—	—	31,254	<b>73,655</b>
Treasury bills issued or guaranteed by Canada	5,997	—	—	—	<b>17,999</b>
Treasury bills issued or guaranteed by provinces	4,492	8,693	9,097	9,987	<b>36,827</b>
Other debt securities	3,976	500	6,596	3,044	—
	<b>74,477</b>	<b>76,411</b>	<b>84,890</b>	<b>80,918</b>	<b>209,810</b>

Table 4/5. Credit risk – general disclosures for all banks (continued)

Residential reverse mortgages

Geographic region and loan-to-value

Residential reverse mortgages are lifetime, interest accruing mortgages that are secured by residential real property. Interest income is recognized on an accrual basis on all mortgages and is due together with repayment of the principal at the time the property is vacated by the homeowner(s). There are no contractual maturity dates for repayment of the mortgages and all mortgages are uninsured.

The following tables show the composition of the residential reverse mortgage portfolio by geographic region and loan-to-value (LTV) ratio range, which measures the outstanding mortgage balance as a percentage of the most recent appraised value of the property. The overall weighted average LTV of the portfolio at 37.2% indicates significant equity in the collateral which would mitigate the risk from economic downturns.

	Dec 31 2014	Mar 31 2015	Jun 30 2015	Sep 30 2015	Dec 31 2015
<i>Province (in thousands of Canadian dollars)</i>	<i>\$</i>	<i>\$</i>	<i>\$</i>	<i>\$</i>	<i>\$</i>
Ontario	618,880	634,136	647,764	673,099	<b>699,982</b>
British Columbia	561,948	574,186	589,177	597,664	<b>616,390</b>
Alberta	225,684	233,899	240,174	248,312	<b>258,852</b>
Quebec	186,662	192,301	200,627	208,216	<b>212,781</b>
Other Canadian provinces	123,273	128,257	134,342	140,419	<b>148,804</b>
	1,716,447	1,762,779	1,812,084	1,867,710	<b>1,936,809</b>
	Dec 31 2014	Mar 31 2015	Jun 30 2015	Sep 30 2015	Dec 31 2015
<i>Provincial LTV %</i>	<i>%</i>	<i>%</i>	<i>%</i>	<i>%</i>	<i>%</i>
Ontario	37.7	37.6	37.3	37.2	<b>37.0</b>
British Columbia	36.8	37.0	37.1	36.6	<b>36.6</b>
Alberta	39.3	39.5	39.6	39.6	<b>39.4</b>
Quebec	36.4	36.5	36.7	36.9	<b>37.3</b>
Other Canadian provinces	36.2	36.3	36.5	36.7	<b>36.9</b>
	37.4	37.4	37.4	37.3	<b>37.2</b>

Table 4/5. Credit risk – general disclosures for all banks (continued)

Residential reverse mortgages (continued)

	Dec 31 2014	Mar 31 2015	Jun 30 2015	Sep 30 2015	Dec 31 2015
Loan-to-value (in thousands of Canadian dollars)	\$	\$	\$	\$	\$
Less than 30.0%	272,553	275,059	287,787	302,582	<b>317,597</b>
30.1% - 40.0%	403,427	411,299	427,305	444,234	<b>447,384</b>
40.1% - 50.0%	527,135	540,492	552,023	559,756	<b>579,741</b>
50.1% - 60.0%	349,034	361,377	362,144	378,794	<b>408,733</b>
60.1% - 70.0%	115,424	119,027	125,033	127,279	<b>129,799</b>
Greater than 70.1%	48,874	55,525	57,792	55,065	<b>53,555</b>
	<b>1,716,447</b>	<b>1,762,779</b>	<b>1,812,084</b>	<b>1,867,710</b>	<b>1,936,809</b>
Overall LTV	37.4%	37.4%	37.4%	37.3%	<b>37.2%</b>

Impaired loans

The following table shows residential reverse mortgages with a loan-to-value ratio of greater than 83%, which management considers impaired, and the appraised value of those underlying properties:

	Dec 31 2014	Mar 31 2015	Jun 30 2015	Sep 30 2015	Dec 31 2015
(in thousands of Canadian dollars)	\$	\$	\$	\$	\$
Mortgage principal plus accrued interest	11,607	11,629	13,872	16,707	<b>16,786</b>
Individual allowances	(1,715)	(1,654)	(1,829)	(2,111)	<b>(1,996)</b>
	<b>9,892</b>	<b>9,975</b>	<b>12,043</b>	<b>14,596</b>	<b>14,790</b>
Appraised value of underlying properties	11,920	11,969	14,509	17,559	<b>17,819</b>

**Table 4/5. Credit risk – general disclosures for all banks (continued)**

**Residential reverse mortgages (continued)**

**Allowance for mortgage losses**

The allowance for mortgage losses is maintained at a level that is considered adequate to absorb incurred losses to the mortgage loan portfolio. A mortgage allowance is recorded when, in the opinion of management, there is no longer reasonable assurance of the collection of the full amount of principal and interest. Mortgage allowances, in an amount that approximates the present value of projected future cashflow shortfalls are determined based on mortgage loans outstanding and the most recently adjusted appraised value of the underlying properties. The Bank has both individual and collective allowances as described below.

**Individual allowances**

Individual allowances are recorded when, due to identified conditions specific to a particular mortgage, management believes there is no longer reasonable assurance of the collection of the full amount of principal and interest.

**Collective allowances**

Collective allowances are provided for losses incurred within the mortgage portfolio but not yet specifically identified and therefore not yet captured in the determination of individual allowances. The Bank evaluates and monitors the underwriting performance indicators of mortgages as well as changes in the characteristics of the portfolio. These indicators include a review of general real estate conditions and trends and their potential impact on the portfolio, the expected occupancy term and interest rates experienced over the life of a mortgage compared to initial underwriting assumptions.

**HomeEquity Bank**  
**Basel III Pillar 3 Disclosures**  
**December 31, 2015**

**Table 4/5. Credit risk – general disclosures for all banks (continued)**

Residential reverse mortgages (continued)

Allowance for mortgage losses (continued)

	Dec 31 2014 \$	Mar 31 2015 \$	Jun 30 2015 \$	Sep 30 2015 \$	Dec 31 2015 \$
<i>(in thousands of Canadian dollars)</i>					
<b>Individual allowances</b>					
Balance, beginning of period	(1,304)	(1,715)	(1,715)	(1,715)	<b>(1,715)</b>
Provision for credit losses	(1,433)	(450)	(780)	(1,317)	<b>(1,535)</b>
Write-offs	751	480	601	732	<b>962</b>
Recoveries	271	31	65	189	<b>292</b>
Balance, end of period	<b>(1,715)</b>	<b>(1,654)</b>	<b>(1,829)</b>	<b>(2,111)</b>	<b>(1,996)</b>
<b>Collective allowances</b>					
Balance, beginning of period	(3,648)	(3,659)	(3,659)	(3,659)	<b>(3,659)</b>
Provision for credit losses	(11)	(670)	(693)	(765)	<b>(396)</b>
Balance, end of period	<b>(3,659)</b>	<b>(4,329)</b>	<b>(4,352)</b>	<b>(4,424)</b>	<b>(4,055)</b>
<b>Total allowances</b>	<b>(5,374)</b>	<b>(5,983)</b>	<b>(6,181)</b>	<b>(6,535)</b>	<b>(6,051)</b>
<b>As a % of total mortgages outstanding</b>	<b>0.31%</b>	<b>0.34%</b>	<b>0.34%</b>	<b>0.35%</b>	<b>0.31%</b>

**TABLE 8. General disclosure for exposures related to counterparty credit risk**

#### Derivative instruments

In the normal course of business, the Bank enters into interest rate derivative contracts to manage interest rate risk, following internal interest rate risk management policies. Derivative financial instruments are financial contracts that derive their value from underlying changes in interest rates or other financial measures.

Interest rate swaps are contracts in which two counterparties agree to exchange cash flows over a period of time based on rates applied to a specified notional principal amount. A typical interest rate swap would require one counterparty to pay interest based on a fixed rate and receive interest based on a variable market interest rate determined from time to time with both calculated on a specified notional principal amount. No exchange of principal amount takes place at inception.

A bond forward is a contractual obligation for the contract holder to purchase or sell a bond on a specified date at a predetermined price. The Bank uses bond forwards to hedge changes in future cash flows attributable to interest rate fluctuations arising on highly probable forecasted issuances of fixed-rate medium-term debt. No exchange of principal amount takes place at inception.

The Bank's International Swaps and Derivatives Association agreements require a credit support obligation in the form of government issued securities under certain circumstances. At December 31, 2015, there was no requirement for the Bank to post collateral under these agreements.

#### Market risk

Derivative financial instruments have either no or an insignificant market value at inception. Their value changes in response to relevant interest rate, foreign exchange rate or credit price changes, such that the previously contracted terms of the derivative transactions have become more or less favourable than what can be negotiated under current market conditions for contracts with the same terms and the same remaining period to expiry. The potential for derivatives to increase or decrease in value as a result of the foregoing factors is generally referred to as market risk. This market risk exposure to earnings is mitigated as the Bank does not hold or use any derivative contracts for speculative trading purposes.

#### Credit risk

Credit risk on derivative financial instruments is the risk of a financial loss occurring as a result of a default of a counterparty on its obligation to the Bank. Credit risk is limited by dealing only with Schedule I Canadian chartered banks as counterparties. The maximum derivative credit exposure to the Bank is the fair value of derivative contracts presented in the summary table below.

TABLE 8. General disclosure for exposures related to counterparty credit risk (continued)

	Dec 31 2014	Mar 31 2015	Jun 30 2015	Sep 30 2015	Dec 31 2015
<i>(in thousands of Canadian dollars)</i>	\$	\$	\$	\$	\$
<b>Derivative financial instrument assets</b>					
Notional principal	1,025,000	925,000	1,555,000	930,000	<b>1,015,000</b>
Replacement cost	6,063	15,514	11,406	14,023	<b>11,444</b>
Credit risk equivalent	9,639	18,403	14,296	17,313	<b>14,605</b>
Risk-weighted assets	1,927	3,681	2,861	3,463	<b>2,922</b>
Fair value	6,063	15,514	11,406	14,023	<b>11,444</b>

**Maturity terms**

The following tables summarize the notional principal and fair value by term to maturity of derivative financial instruments outstanding as at December 31, 2015. Maturity dates range from within 1 year to within five years of December 31, 2015.

	Dec 31 2014	Mar 31 2015	Jun 30 2015	Sep 30 2015	Dec 31 2015
<i>(in thousands of Canadian dollars)</i>	\$	\$	\$	\$	\$
<b>Notional principal</b>					
<b>Derivative assets</b>					
Maturing within 1 year	310,000	347,000	498,000	318,000	<b>383,000</b>
Maturing in 1 to 3 years	492,000	342,000	381,000	381,000	<b>381,000</b>
Maturing in 3 to 5 years	223,000	236,000	171,000	251,000	<b>251,000</b>
	1,025,000	925,000	1,050,000	950,000	<b>1,015,000</b>
<b>Derivative liabilities</b>					
Maturing within 1 year	195,000	430,000	400,000	325,000	<b>255,000</b>
Maturing in 1 to 3 years	20,000	25,000	25,000	—	—
Maturing in 3 to 5 years	—	—	80,000	—	—
	215,000	455,000	505,000	325,000	<b>255,000</b>

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**TABLE 8. General disclosure for exposures related to counterparty credit risk (continued)**

**Maturity terms (continued)**

	Dec 31 2014	Mar 31 2015	Jun 30 2015	Sep 30 2015	Dec 31 2015
<i>(in thousands of Canadian dollars)</i>	\$	\$	\$	\$	\$
<b>Fair value</b>					
<b>Derivative assets</b>					
Maturing within 1 year	1,215	3,033	281	1,258	<b>495</b>
Maturing in 1 to 3 years	2,978	5,300	5,063	6,755	<b>5,650</b>
Maturing in 3 to 5 years	1,870	7,181	6,062	6,010	<b>5,299</b>
	<u>6,063</u>	<u>15,514</u>	<u>11,406</u>	<u>14,023</u>	<u><b>11,444</b></u>
<b>Derivative liabilities</b>					
Maturing within 1 year	560	2,604	181	206	<b>492</b>
Maturing in 1 to 3 years	—	398	122	—	—
Maturing in 3 to 5 years	—	—	550	—	—
	<u>560</u>	<u>3,002</u>	<u>853</u>	<u>206</u>	<u><b>492</b></u>

**TABLE 12. Operational risk**

The Bank's Operational Risk Management Framework (ORMF) is an integrated part of the Bank's Enterprise Risk Management Framework and is aligned with the Board-Approved RAF. The ORMF governance structure has three lines of defence to safeguard the Bank against operational risk. The first line of defence from operational risk is at the transaction level where the Bank's business units are responsible for ensuring that appropriate internal controls are in place and operating effectively. The Bank also has Risk and Compliance Departments (second line of defence) which serves as independent challenge to the business units and whose function is to identify key operational risks that the Bank is exposed to and independently validates the effectiveness of the Bank's operational internal controls. The Bank also has an Internal Audit function (third line of defence) which audits the Bank using a risk-based approach.

The Bank mitigates its operational risk by implementing policies and procedures directed at identified risks, employing knowledgeable and experienced senior managers, segregating duties among employees, training all employees with respect to effective risk management, and continually reviewing and upgrading the policies, procedures and controls that form the Bank's Operational Risk Framework. Effective risk management plays an essential role in the Bank's ability to meet its financial targets and remain financially sound.

Senior Management is responsible for identifying risks and developing risk management policies. The Board of Directors, both directly or through its committees, reviews and approves Bank policies, and implements specific reporting procedures to enable it to monitor the Bank's risk profile and ensure compliance with the Board-approved Risk Appetite Framework. The Bank uses the basic indicator approach to measure operational risk in its calculation of risk-weighted assets. Operational risk is calculated as shown in Table 3 Capital Adequacy.

**TABLE 14. Interest rate risk**

**Objectives, policies and processes**

The Bank's operating margin is primarily derived from the spread between interest earned on the mortgage portfolio and the interest paid on the debt and deposits used to fund the portfolio. Mortgages have various interest rate reset terms, ranging from variable to five-year. Interest on all of the Bank's debt is fixed until maturity. The Bank uses derivative contracts to alter the fixed rate on the debt to match the rate reset terms of the mortgage portfolio and to mitigate any fluctuations that changes to the underlying benchmark rates may have on its operating margin at the time of the mortgage resets. Interest rates on approximately 19% of the mortgage portfolio are based on the Government of Canada Treasury-bill and bond rates whereas interest rates on the debt and derivative instruments are based on the Bankers' Acceptance rates. Historically, changes in interest rates do not impact each benchmark rate equally, which may result in a variation in spread.

The Bank's Management is responsible for monitoring, managing and reporting interest rate risk in accordance with Board-approved RAF. To support the RAF, the Bank has developed an Enterprise Risk Management Framework which includes the Board-approved Risk Policies. Compliance with various internal limits articulated in the RAF for net interest income and market value sensitivities are periodically reported to the Bank's Conduct Review and Risk Management Committee which has the oversight responsibility for risk governance and practices.

**TABLE 14. Interest rate risk (continued)**

**Exposure to interest rate risk**

The Bank is exposed to interest rate risk as a result of the mismatch, or gap, between the maturity or repricing date of interest sensitive assets and liabilities. The following table identifies the Bank's assets and liabilities which are sensitive to interest rate movements and those which are non-interest rate sensitive.

	Dec 31 2014	Mar 31 2015	Jun 30 2015	Sep 30 2015	Dec 31 2015
<i>(in thousands of Canadian dollars)</i>	\$	\$	\$	\$	\$
<b>Interest sensitive</b>					
Total assets	1,796,987	1,854,704	1,908,380	1,962,650	<b>2,158,063</b>
Total liabilities and equity	1,674,022	1,733,580	1,783,002	1,827,718	<b>2,017,199</b>
Total interest rate sensitivity gap	122,965	121,124	125,378	134,932	<b>140,864</b>
<b>Non-interest sensitive</b>					
Total assets	44,225	44,497	45,259	44,199	<b>45,708</b>
Total liabilities and equity	167,190	165,621	170,637	179,131	<b>186,572</b>
Total interest rate sensitivity gap	(122,965)	(121,124)	(125,378)	(134,932)	<b>(140,864)</b>

**Interest rate sensitivity**

The following table provides the potential before-tax impact of an immediate and sustained 100 bps increase or decrease in interest rates on net income. These sensitivities are hypothetical and should be used with caution.

	Dec 31 2014	Mar 31 2015	Jun 30 2015	Sep 30 2015	Dec 31 2015
<i>(in thousands of Canadian dollars)</i>	\$	\$	\$	\$	\$
Before-tax impact on net income of:					
100 bps increase in interest rates	42	328	35	45	<b>185</b>
100 bps decrease in interest rates	(42)	(328)	(35)	(45)	<b>(185)</b>

## REMUNERATION

The Bank's remuneration policies are consistent with financial services industry practice. Rewards are based on both on business and individual specific performance objectives. Oversight of the Bank's compensation structure is the responsibility of the Compensation Committee, which is comprised of three Directors, two of whom are independent. The Compensation Committee met once in 2015. External compensation advisors are retained by the Compensation Committee as needed.

The Bank's compensation structure includes base salary, short-term cash incentives and for executives a long-term incentive plan. Base salary for all employees are reviewed annually and as required by market conditions. In addition to their salaries, Bank employees participate in a benefits plan that provides certain health care, dental care, life insurance and other benefits. Bank employees also participate in a combination Group Registered Savings Plan/Deferred Profit Sharing Plan.

### Executive Management

The Bank's executive compensation program is guided by the tenet that a meaningful portion of key management personnel's pay should be based on business results. Pay for performance encourages senior management to make decisions and take actions that are aligned with the Bank's business objectives and shareholders' interests. The Bank's executive compensation program for vice-presidents, senior vice-presidents and the president and chief executive officer is built on the core principles of balanced compensation and risk, market competitiveness and shareholder value creation. Other than executive management, there are no other material risk takers at the Bank.

A measured approach to compensation is required. Incentives must drive the right behaviours within the Bank's risk appetite. Incentive compensation plans must factor in risk, rewarding results that are achieved only within a defined risk tolerance. In order for the Bank to achieve its strategic goals it needs to attract, motivate and retain experienced talent and leadership. Compensation opportunities are to be competitive with similarly sized Canadian financial institutions. There must be a strong link between incentive compensation and long-term shareholder value creation. Management's compensation opportunity must be tied to the achievement of objectives that create sustainable growth and long-term shareholder value. The salaries are set in reference to the executive's level of responsibility, competitive market data, internal pay relationships and the individual's proven capabilities. Every year the CEO makes a recommendation to the Compensation Committee for each executive's base salary.

**REMUNERATION (continued)**

Key management personnel and Directors compensation for 2015 and 2014 was comprised of:

<i>(in thousands of Canadian dollars)</i>	Number of recipients	2015 \$	Number of recipients	2014 \$
Fixed remuneration				
Cash-based	9	2,029	10	2,306
Severance payments	2	684	1	282
Directors' fees and expenses	5	255	5	254
		<b>2,968</b>		<b>2,842</b>
Variable remuneration				
Cash-based	7	669	9	817
		<b>3,637</b>		<b>3,659</b>

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**Modified Capital Disclosure Template**

The following summarizes the Bank's interim transitional and all-in capital Basel III Pillar 3 disclosures as at December 31, 2015:

<i>Modified Capital Disclosure Template (in thousands of Canadian dollars)</i>		<b>ALL-IN BASIS</b>	<b>TRANSITIONAL BASIS</b>
<b>Common Equity Tier 1 capital: instruments and reserves</b>			
1	Directly issued qualifying common share capital (and equivalent for non-joint stock companies) plus related stock surplus	<b>134,261</b>	
2	Retained earnings	<b>(259)</b>	
3	Accumulated other comprehensive income (and other reserves)	<b>(1,182)</b>	
4	<i>Directly issued capital subject to phase out from CET1 (only applicable to non-joint stock companies)</i>		
5	Common share capital issued by subsidiaries and held by third parties (amount allowed in group CET1)		
6	<b>Common Equity Tier 1 capital before regulatory adjustments</b>	<b>132,820</b>	
<b>Common Equity Tier 1 capital: regulatory adjustments</b>			
28	Total regulatory adjustments to Common Equity Tier 1	<b>1,167</b>	
29	<b>Common Equity Tier 1 capital (CET1)</b>	<b>131,653</b>	<b>132,689</b>
<b>Additional Tier 1 capital: instruments</b>			
30	Directly issued qualifying Additional Tier 1 instruments plus related stock surplus		
31	of which: classified as equity under applicable accounting standards		
32	of which: classified as liabilities under applicable accounting standards		
33	Directly issued capital instruments subject to phase out from Additional Tier 1		
34	Additional Tier 1 instruments (and CET1 instruments not included in row 5) issued by subsidiaries and held by third parties (amount allowed in group AT1)		
35	of which: instruments issued by subsidiaries subject to phase out		
36	<b>Additional Tier 1 capital before regulatory adjustments</b>	<b>—</b>	
<b>Additional Tier 1 capital: regulatory adjustments</b>			
43	<b>Total regulatory adjustments to Additional Tier 1 capital</b>		
44	<b>Additional Tier 1 capital (AT1)</b>	<b>—</b>	
45	<b>Tier 1 capital (T1 = CET1 + AT1)</b>	<b>131,653</b>	<b>132,689</b>
<b>Tier 2 capital: instruments and allowances</b>			
46	Directly issued qualifying Tier 2 instruments plus related stock surplus	<b>20,283</b>	
47	Directly issued capital instruments subject to phase out from Tier 2		
48	Tier 2 instruments (and CET1 and AT1 instruments not included in rows 5 or 34) issued by subsidiaries and held by third parties (amount allowed in group Tier 2)		
49	of which: instruments issued by subsidiaries subject to phase out		
50	Collective allowances	<b>3,854</b>	
51	<b>Tier 2 capital before regulatory adjustments</b>	<b>24,137</b>	
<b>Tier 2 capital: regulatory adjustments</b>			
57	<b>Total regulatory adjustments to Tier 2 capital</b>	<b>—</b>	
58	<b>Tier 2 capital (T2)</b>	<b>24,137</b>	
59	<b>Total capital (TC = T1 + T2)</b>	<b>155,790</b>	<b>156,826</b>

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60	<b>Total risk weighted assets</b>	<b>1,022,264</b>	<b>1,022,591</b>
<b>Capital ratios</b>			
61	Common Equity Tier 1 (as a percentage of risk weighted assets)	<b>12.9%</b>	<b>13.0%</b>
62	Tier 1 (as a percentage of risk weighted assets)	<b>12.9%</b>	<b>13.0%</b>
63	Total capital (as a percentage of risk weighted assets)	<b>15.2%</b>	<b>15.3%</b>
<b>OSFI all-in target</b>			
69	Common Equity Tier 1 capital all-in target ratio		
70	Tier 1 capital all-in target ratio		
71	Total capital all-in target ratio		
<b>Capital instruments subject to phase-out arrangements (only applicable between 1 Jan 2013 and 1 Jan 2022)</b>			
80	<i>Current cap on CET1 instruments subject to phase out arrangements</i>		
81	<i>Amount excluded from CET1 due to cap (excess over cap after redemptions and maturities)</i>		
82	<i>Current cap on AT1 instruments subject to phase out arrangements</i>		
83	<i>Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)</i>		
84	<i>Current cap on T2 instruments subject to phase out arrangements</i>		
85	<i>Amount excluded from T2 due to cap (excess over cap after redemptions and maturities)</i>		

**Leverage Ratio Template**

The following summarizes the Bank's all-in Basel III Pillar 3 Leverage Ratio as at December 31, 2015:

<i>Item (in thousands of Canadian dollars)</i>		<i>Leverage Ratio Framework</i>
<b>On-balance sheet exposures</b>		
1	On-balance sheet items (excluding derivatives, SFTs and grandfathered securitization exposures but including collateral)	<b>2,202,213</b>
2	(Asset amounts deducted in determining Basel III transitional Tier 1 capital)	<b>(1,167)</b>
3	<b>Total on-balance sheet exposures</b> (excluding derivatives and SFTs) (sum of lines 1 and 2)	<b>2,201,046</b>
4	Replacement cost associated with all derivative transactions (ie net of eligible cash variation margin)	<b>11,444</b>
5	Add-on amounts for PFE associated with all derivative transactions	<b>3,160</b>
6	Gross up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the operative accounting framework	
7	(Deductions of receivables assets for cash variation margin provided in derivative	
8	(Exempted CCP-leg of client cleared trade exposures)	
9	Adjusted effective notional amount of written credit derivatives	
10	(Adjusted effective notional offsets and add-on deductions for written credit derivatives)	
11	<b>Total derivative exposures (sum of lines 4 to 10)</b>	<b>14,604</b>
12	Gross SFT assets (with no recognition of netting), after adjusting for sale accounting	
13	(Netted amounts of cash payables and cash receivables of gross SFT assets)	
14	Counterparty credit risk (CCR) exposure for SFT assets	
15	Agent transaction exposures	
16	<b>Total securities financing transaction exposures (sum of lines 12 to 15)</b>	—
17	Off-balance sheet exposure at gross notional amount	
18	(Adjustments for conversion to credit equivalent amounts)	
19	<b>Off-balance sheet items (sum of lines 17 and 18)</b>	—
20	<b>Tier 1 capital</b>	<b>131,652</b>
21	<b>Total Exposures (sum of lines 3, 11, 16 and 19)</b>	<b>2,215,650</b>
22	<b>Basel III leverage ratio</b>	<b>5.94%</b>