BASEL III PILLAR 3 DISCLOSURES

December 31, 2012

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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 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 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 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 on at least a quarterly basis.

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 Bank's 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 on a quarterly basis and the ICAAP is reviewed annually prior to recommendation by the CRRMC to the Board for approval.

Table 1. Scope of application (continued)

Corporate governance

The Bank maintains a rigorous corporate governance structure as follows:

- Board of Director's 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 Bank seeks to achieve long-term sustainable risk adjusted growth in order to ensure its health and stability of earnings while protecting its well respected brand name and reputation, the interests of its depositors and customers and investors.

The Board will also ensure:

- Management of regulatory compliance and aims to be fully compliant with the regulatory limits, constraints, and requirements within the respective specified timeframes.
- Maintenance of capital adequacy as required by the regulators.
- Sound and successful management of risks that the Bank is exposed to, mainly, but not limited to: credit, competition, funding and liquidity, interest rate, media and reputational, operational, and regulatory risks.
- Maintenance of a stable and strong risk profile and the elimination of risks not central to the business strategy.

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 as listed below:

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 1. Scope of application (continued)

Competition 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 with 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.

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, being referenced to different underlying instruments or when the long term expectation of the quality of assets diminishes. 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.

Media and reputation 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.

Operational risk

Operational risk can arise through breakdowns in internal controls and corporate governance, resulting in financial loss. The Bank has implemented policies, procedures and internal controls to detect, prevent and manage business activity and to control operational risk.

Regulatory 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 and Risk Management functions keep the Management team and the Board informed of applicable new regulations, guidelines and changes to existing regulatory requirements.

Table 2. 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 retained earnings 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, 2012, the Bank had 108,683 common shares issued and outstanding.

(in thousands of Canadian dollars)	**2012** **$**	2011 $
Common shares	**129,262**	111,837
Deficit	**(32,750)**	(35,077)
Regulatory adjustments	**(371)**	(422)
Tier 1 capital	**96,141**	76,338
Book value of unsecured subordinated debt	**40,975**	40,975
Less: accumulated amortization for capital adequacy purposes	**12,000**	8,000
	28,975	32,975
Regulatory adjustments	**3,563**	—
Tier 2 capital	**32,538**	32,975
Tier 1 capital and Total regulatory capital	**128,679**	109,313

Table 3. 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 and comparable to other similar companies.

The Bank's capital resources consist of equity and unsecured subordinated debt. The regulatory capital requirements are specified by OSFI in its *Guideline A, Capital Adequacy Requirement (CAR) – Simpler Approaches*. The Guideline specifies the types of items included in capital and the measures OSFI will consider in reviewing capital adequacy. There are two capital standards addressed in the Bank's Capital Management Policy: risk-based capital ratios and assets-to-capital multiple. The Bank has implemented policies and procedures to monitor compliance with regulatory capital requirements.

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 43.7% at December 31, 2012. All other assets are risk-weighted at 100%.

Risk-weighted assets *(in thousands of Canadian dollars)*	**2012** **$**	2011 $
Corporate debt securities	**9,098**	1,799
Provincial treasury bills	**594**	598
Bank debt securities	**13,918**	4,314
Residential reverse mortgages	**583,444**	517,419
Other assets	**57,983**	58,976
	665,037	583,106
Off-balance sheet exposure	**3,703**	6,454
Credit risk	**668,740**	589,560
Operational risk (average three-year gross income)	**47,031**	43,987
Total risk-weighted assets	**715,771**	633,547

Table 3. Capital adequacy (continued)

Capital ratios

	2012	2011
Tier 1 Capital Ratio (1)	**13.4%**	12.1%
Total Capital Ratio (2)	**18.0%**	17.3%
Assets-to-Capital multiple (3)	**11.9x**	11.9x

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

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

(3) The Assets-to-Capital multiple is calculated by dividing total assets, including specified off-balance sheet items net of other specified deductions, by total capital.

The Bank's ratios are above internal minimum targets for both the Tier 1 and Total Capital ratios and below internal maximum target for the Bank's Assets-to-Capital multiple . The Bank's internal minimum and maximum targets are determined by the ICAAP.

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 CRRMC assists 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 1.0%. 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.

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

Cash resources and securities

(in thousands of Canadian dollars)	Within 1 year $	1 to 5 years $	Over 5 years $	2012 $	2011 $
Cash and non-interest bearing deposits with banks	**40,225**	—	—	**40,225**	18,610
Bank debt securities	**29,363**	—	—	**29,363**	2,968
Treasury bills issued or guaranteed by Canada	**4,981**	—	—	**4,981**	—
Treasury bills issued or guaranteed by provinces	**2,969**	—	—	**2,969**	2,989
Other debt securities	**45,491**	—	—	**45,491**	8,994
	123,029	—	—	**123,029**	33,561

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 distribution 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 36.9% indicates significant equity in the collateral which would mitigate the risk from economic downturns.

Province *(in thousands of Canadian dollars)*	2012 $	2011 $	2012 Provincial LTV %	2012 %	2011 Provincial LTV	2011 %
Ontario	**485,445**	440,992	**38.3**	**36.4**	38.6	37.2
British Columbia	**470,071**	425,199	**35.7**	**35.2**	34.9	35.9
Alberta	**169,437**	149,293	**37.8**	**12.7**	35.6	12.6
Quebec	**133,573**	107,363	**35.9**	**10.0**	35.5	9.1
Other	**76,547**	62,177	**35.6**	**5.7**	34.8	5.2
	1,335,073	1,185,024	**36.9**	**100.0**	36.4	100.0

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

Residential reverse mortgages (continued)

Loan-to-value *(in thousands of Canadian dollars)*	**2012** **$**	2011 $	**2012** **%**	2011 %
Less than 30.0%	**219,325**	205,729	**16.4**	17.4
30.1% - 40.0%	**358,113**	339,169	**26.8**	28.6
40.1% - 50.0%	**406,602**	353,605	**30.5**	29.8
50.1% - 60.0%	**248,370**	199,882	**18.6**	16.9
60.1% - 70.0%	**73,007**	67,174	**5.5**	5.7
Greater than 70.1%	**29,656**	19,465	**2.2**	1.6
	1,335,073	1,185,024	**100.0**	100.0
Weighted average LTV			**36.9**	36.4

Impaired loans

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

(in thousands of Canadian dollars)	**2012** **$**	2011 $
Mortgage principal plus accrued interest	**7,350**	3,344
Individual allowances	**(660)**	(485)
	6,690	2,859
Appraised value of underlying properties	**8,060**	3,419

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 cash flow 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.

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

Residential reverse mortgages (continued)

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.

(in thousands of Canadian dollars)	**2012** **$**	2011 $
Individual allowances		
Balance, beginning of year	**(485)**	(638)
Provision for credit losses	**(570)**	(276)
Write-offs	**388**	252
Recoveries	**7**	177
Balance, end of year	**(660)**	(485)
Collective allowances		
Balance, beginning of year	**(2,969)**	(2,547)
Provision for credit losses	**(594)**	(422)
Balance, end of year	**(3,563)**	(2,969)
Total allowances	**(4,223)**	(3,454)
As a % of total mortgages outstanding	**0.32%**	0.29%

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.

Forward rate agreements (FRAs) are contracts that effectively fix a future interest rate for a period of time. A typical FRA provides that, at a pre-determined future date, a cash settlement will be made between counterparties based on the difference between a contracted rate and a market rate to be determined in the future, calculated on a specified notional principal amount. 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, 2012 and 2011, there were no circumstances that required 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)

(in thousands of Canadian dollars)	Notional Principal $	Replacement Cost $	Credit risk equivalent $	Risk-weighted assets $	Fair value $
2012					
Swaps					
Maturing within 1 year	**322,000**	**439**	**439**	**88**	**439**
Maturing in 1 to 3 years	**318,000**	**7,829**	**9,419**	**1,884**	**7,829**
Maturing in 3 to 5 years	**265,000**	**7,334**	**8,659**	**1,731**	**7,334**
	905,000	**15,602**	**18,517**	**3,703**	**15,602**
2011					
Swaps					
Maturing within 1 year	183,700	1,600	1,600	320	1,600
Maturing in 1 to 3 years	322,500	5,742	7,354	1,471	5,742
Maturing in 3 to 5 years	392,500	21,338	23,301	4,660	21,338
FRAs					
Maturing within 1 year	50,000	13	13	3	13
	948,700	28,693	32,268	6,454	28,693

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

Maturity terms

The following table summarizes the notional principal and fair value by term to maturity of derivative financial instruments outstanding as at December 31, 2012 and 2011. Maturity dates range from February 2013 to May 2016.

(in thousands of Canadian dollars)	Within 1 year $	1 to 3 years $	3 to 5 years $	Over 5 years $	2012 $	2011 $
Notional principal						
Swaps	**322,000**	**318,000**	**265,000**	—	**905,000**	898,700
FRAs	—	—	—	—	—	50,000
Derivative assets	**322,000**	**318,000**	**265,000**	—	**905,000**	948,700
Swaps	**69,500**	—	**104,000**	—	**173,500**	26,500
Derivative liabilities	**69,500**	—	**104,000**	—	**173,500**	26,500
Fair values						
Swaps	**439**	**7,829**	**7,334**	—	**15,602**	28,680
FRAs	—	—	—	—	—	13
Derivative assets	**439**	**7,829**	**7,334**	—	**15,602**	28,693
Swaps	**142**	—	**434**	—	**576**	577
Derivative liabilities	**142**	—	**434**	—	**576**	577

TABLE 12. Operational risk

Operational risk can arise through breakdowns in internal controls and corporate governance, resulting in financial loss. The Bank has implemented policies, procedures and internal controls to detect, prevent and manage business activity and to control operational risk. The Bank’s Operation Risk Management Committee is responsible for the oversight of operational risk, with assistance from various internal business groups.

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 39% 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 the Board-approved RAF. Compliance with various internal limits articulated in the RAF for net interest income and market value sensitivities are periodically reported to the Bank's CRRMC which has the oversight responsibility for risk governance and practices.

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.

	2012	**2012**	2011	2011
	$	**$**	$	$
(in thousands of Canadian dollars)	**Interest Sensitive**	**Non-interest Sensitive**	Interest Sensitive	Non-interest Sensitive
Total assets	**1,473,704**	**47,524**	1,247,278	46,620
Total liabilities and equity	**1,384,053**	**137,175**	1,177,871	116,027
Total interest rate sensitivity gap	**89,651**	**(89,651)**	69,407	(69,407)

TABLE 14. Interest rate risk in the banking book (continued)

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.

(in thousands of Canadian dollars)	**2012** **$**	2011 $
Before-tax impact on net income of:		
100 bps increase in interest rates	**237**	94
100 bps decrease in interest rates	**(237)**	(94)

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 independent Directors. The Compensation Committee meets at least twice annually, and met three times in 2012. 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 and a 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)

Prior to November 30, 2012, while the Bank's parent, HOMEQ was still publicly traded, Directors and executive management participated in HOMEQ's long-term incentive plans (LTIPs) and received shares under various plans. These plans ceased on November 30, 2012, when HOMEQ was acquired by Birch Hill Equity Partners Management Inc. and became a privately-held company.

Key management personnel and Directors compensation for 2012 was comprised of:

(in thousands of Canadian dollars)	**Number of recipients**	**2012 $**	Number of recipients	2011 $
Fixed remuneration				
Cash-based	**10**	**2,060**	8	1,855
Share-based (1)	**10**	**973**	8	368
Severance payments	—	—	1	59
Directors fees, expenses and share-based (1)	**8**	**1,805**	8	414
		4,838		2,696
Variable remuneration				
Cash-based	**10**	**928**	8	637
		5,766		3,333

(1) 2012 includes the settlement of LTIPs during the acquisition of HOMEQ by Birch Hill Equity Partners Management Inc., described above.