BASEL III PILLAR 3 DISCLOSURES

September 30, 2013

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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 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 Office of the Superintendent of Financial Institutions Canada, and reflect, where necessary, management's best estimates and judgments. This report is unaudited.

Risk Management

The Bank's Management and Board of Directors (Board) have developed and approved a Capital Management Policy in accordance with the Enterprise Risk Management Framework (ERMF) which includes the Bank's risk appetite framework and stress testing program. Adherence to the Capital Management Policy ensures that the Bank has sufficient capital to maintain its operations based on current activities, expected business developments in the future and the possibility of various disruptive or adverse scenarios. Such 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 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 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 magnitude of capital required to enable management and the Board to set capital levels appropriate with the Bank's risk appetite.

The Bank's Conduct Review and Risk Management Committee (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 prescribed frequency 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 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 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.

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 of Directors (the Board) informed of 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 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 September 30, 2013, the Bank had 108,683 common shares issued and outstanding.

ALL-IN BASIS (in thousands of Canadian dollars)	Sep 30 2012	Dec 31 2012	Mar 31 2013	Jun 30 2013	Sep 30 2013
Common shares	114,055	129,262	129,262	129,262	129,262
Deficit	(32,759)	(32,750)	(31,666)	(30,140)	(27,262)
Regulatory adjustments	(507)	(371)	(979)	(1,050)	(1,096)
Common Equity Tier 1 capital	80,789	96,141	96,617	98,072	100,904
Book value of unsecured subordinated debt	40,975	40,975	40,975	40,975	30,975
Less: accumulated amortization for capital adequacy purposes	10,000	12,000	(14,897)	(16,000)	(6,000)
	30,975	28,975	26,078	24,975	24,975
Regulatory adjustments	3,313	3,563	3,681	4,136	3,579
Tier 2 capital	34,288	32,538	29,759	29,111	28,554
Tier 1 capital and Total regulatory capital	115,077	128,679	126,376	127,183	129,458

TRANSITIONAL BASIS (in thousands of Canadian dollars)	Mar 31 2013	Jun 30 2013	Sep 30 2013
All-in Common Equity Tier 1 capital	96,617	98,072	100,904
Transitional adjustments	558	539	512
Common Equity Tier 1 capital	97,175	98,611	101,416
Tier 2 capital	29,759	29,111	28,554
Tier 1 capital and Total regulatory capital	126,934	127,722	129,970

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 44.5% at September 30, 2013. All other assets are risk-weighted at 100%.

***ALL-IN BASIS* Risk-weighted assets** *(in thousands of Canadian dollars)*	**Sep 30 2012**	**Dec 31 2012**	**Mar 31 2013**	**Jun 30 2013**	**Sep 30 2013**
Corporate debt securities	1,601	9,098	4,718	3,786	4,595
Provincial treasury bills	—	594	—	—	—
Deposits with regulated financial institutions	9,949	13,918	9,106	7,732	12,408
Residential reverse mortgages	564,347	583,444	605,027	622,626	647,247
Other assets	57,110	57,983	57,016	56,829	57,520
	633,007	665,037	675,867	690,973	721,770
Off-balance sheet exposure	4,400	3,703	3,645	2,498	2,482
Credit risk	637,407	668,740	679,512	693,471	724,252
Operational risk (average three-year gross income)	46,262	47,031	47,391	48,722	49,894
Total risk-weighted assets	683,669	715,771	726,903	742,193	774,146

Table 3. Capital adequacy (continued)

TRANSITIONAL BASIS **Risk-weighted assets** ***(in thousands of Canadian dollars)***	Mar 31 2013	Jun 30 2013	Sep 30 2013
Total risk-weighted assets on All-in basis	726,903	742,193	774,146
Transitional adjustments	558	539	512
Total risk-weighted assets on Transitional basis	727,461	742,732	774,658

Capital ratios

ALL-IN BASIS	Sep 30 2012	Dec 31 2012	Mar 31 2013	Jun 30 2013	Sep 30 2013
Tier 1 Capital Ratio (1)	11.8%	13.4%	13.3%	13.2%	13.0%
Total Capital Ratio (2)	16.8%	18.0%	17.4%	17.1%	16.7%
Assets-to-Capital Multiple (3)	12.4x	11.9x	12.0x	12.0x	12.8x

(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.

TRANSITIONAL BASIS	March 31 2013	June 30 2013	Sept 30 2013
Tier 1 Capital Ratio (1)	13.4%	13.3%	13.1%
Total Capital Ratio (2)	17.4%	17.2%	16.8%
Assets-to-Capital Multiple (3)	12.0x	12.0x	12.8x

(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 complied with the OSFI guideline related to capital ratios and the assets-to-capital multiple. Both the Tier 1 and Total Capital Ratios remain above OSFI's stated minimum capital ratios of 7% and 10%, respectively, for a well-capitalized financial institution. The Bank's Assets-to-Capital Multiple remains below the internal maximum targets, which 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 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 0.80%. 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

(in thousands of Canadian dollars)	Sep 30 2012 $	Dec 31 2012 $	Mar 31 2013 $	Jun 30 2013 $	Sep 30 2013 $
Cash and non-interest bearing deposits with banks	39,749	40,225	23,891	29,847	49,056
Bank securities	9,995	29,363	14,892	8,812	12,983
Treasury bills issued or guaranteed by Canada	—	4,981	4,993	3,993	19,991
Treasury bills issued or guaranteed by provinces	—	2,969	2,979	2,988	43,394
Other debt securities	8,006	45,491	23,592	18,930	16,977
	57,750	123,029	70,347	64,570	142,401

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 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)*	Sep 30 2012 $	Dec 31 2012 $	Mar 31 2013 $	Jun 30 2013 $	Sep 30 2013 $
Ontario	469,024	485,445	498,226	507,441	524,589
British Columbia	461,074	470,071	481,548	490,210	503,700
Alberta	165,176	169,437	175,336	180,315	186,450
Quebec	124,863	133,573	139,514	144,257	152,697
Other	72,012	76,547	81,237	85,174	89,973
	1,292,149	1,335,073	1,375,861	1,407,397	1,457,409

Provincial LTV %	Sep 30 2012 %	Dec 31 2012 %	Mar 31 2013 %	Jun 30 2013 %	Sep 30 2013 %
Ontario	38.4	38.3	38.5	38.5	38.5
British Columbia	35.5	35.7	35.9	36.1	36.4
Alberta	37.2	37.8	38.4	39.1	39.1
Quebec	35.6	35.9	36.3	36.3	36.1
Other	35.3	35.6	35.8	35.7	35.7
	36.7	36.9	37.2	37.3	37.4

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

Residential reverse mortgages (continued)

Loan-to-value *(in thousands of Canadian dollars)*	Sep 30 2012 $	Dec 31 2012 $	Mar 31 2013 $	Jun 30 2013 $	Sep 30 2013 $
Less than 30.0%	216,132	219,325	221,683	228,107	239,248
30.1% - 40.0%	352,758	358,113	355,653	351,837	355,009
40.1% - 50.0%	387,272	406,602	425,707	436,114	450,602
50.1% - 60.0%	233,747	248,370	255,614	265,605	275,768
60.1% - 70.0%	72,582	73,007	83,652	85,291	89,994
Greater than 70.1%	29,658	29,656	33,552	40,443	46,788
	1,292,149	1,335,073	1,375,861	1,407,397	1,457,409
Weighted average LTV	36.7%	36.9%	37.2%	37.3%	37.4%

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:

(in thousands of Canadian dollars)	Sep 30 2012 $	Dec 31 2012 $	Mar 31 2013 $	Jun 30 2013 $	Sep 30 2013 $
Mortgage principal plus accrued interest	7,128	7,350	7,048	7,671	9,141
Individual allowances	(690)	(660)	(758)	(895)	(1,228)
	6,438	6,690	6,290	6,776	7,913
Appraised value of underlying properties	7,757	8,060	7,577	8,164	9,534

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

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

Residential reverse mortgages (continued)

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.

(in thousands of Canadian dollars)	Sep 30 2012 $	Dec 31 2012 $	Mar 31 2013 $	Jun 30 2013 $	Sep 30 2013 $
Individual allowances					
Balance, beginning of year	(485)	(485)	(660)	(660)	(660)
Provision for credit losses	(436)	(570)	(167)	(319)	(687)
Write-offs	222	388	—	36	36
Recoveries	9	7	69	48	83
Balance, end of year	(690)	(660)	(758)	(895)	(1,228)
Collective allowances					
Balance, beginning of year	(2,969)	(2,969)	(3,563)	(3,563)	(3,563)
Provision for credit losses	(344)	(594)	(118)	(573)	(16)
Balance, end of year	(3,313)	(3,563)	(3,681)	(4,136)	(3,579)
Total allowances	(4,003)	(4,223)	(4,439)	(5,031)	(4,807)
As a % of total mortgages outstanding	0.31%	0.32%	0.32%	0.36%	0.33%

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 September 30, 2013 $1,500, has been pledged as 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)	Sep 30 2012 $	Dec 31 2012 $	Mar 31 2013 $	Jun 30 2013 $	Sep 30 2013 $
Derivative financial instrument assets					
Notional principal	935,000	905,000	870,000	743,500	646,500
Replacement cost	18,766	15,602	15,299	10,275	10,189
Credit risk equivalent	21,998	18,517	18,227	12,490	12,409
Risk-weighted assets	4,400	3,703	3,645	2,498	2,482
Fair value	18,766	15,602	15,299	10,275	10,189

Maturity terms

The following tables summarize the notional principal and fair value by term to maturity of derivative financial instruments outstanding as at September 30, 2013. Maturity dates range from October 2013 to September 2018.

(in thousands of Canadian dollars)	Sep 30 2012 $	Dec 31 2012 $	Mar 31 2013 $	Jun 30 2013 $	Sep 30 2013 $
Notional principal					
Derivative assets					
Maturing within 1 year	288,500	322,000	284,500	300,500	202,500
Maturing in 1 to 3 years	353,000	318,000	438,500	433,000	409,000
Maturing in 3 to 5 years	293,500	265,000	147,000	10,000	35,000
	935,000	905,000	870,000	743,500	646,500
Derivative liabilities					
Maturing within 1 year	69,500	69,500	69,500	35,000	195,000
Maturing in 1 to 3 years	—	—	—	—	55,000
Maturing in 3 to 5 years	—	104,000	89,000	241,000	216,000
	69,500	173,500	158,500	276,000	466,000

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

Maturity terms (continued)

(in thousands of Canadian dollars)	Sep 30 2012 $	Dec 31 2012 $	Mar 31 2013 $	Jun 30 2013 $	Sep 30 2013 $
Fair value					
Derivative assets					
Maturing within 1 year	1,035	439	626	538	345
Maturing in 1 to 3 years	8,762	7,829	13,212	9,728	9,762
Maturing in 3 to 5 years	8,969	7,334	1,461	9	82
	18,766	15,602	15,299	10,275	10,189
Derivative liabilities					
Maturing within 1 year	263	142	42	1	41
Maturing in 1 to 3 years	—	—	—	—	63
Maturing in 3 to 5 years	—	434	145	4,156	3,283
	263	576	187	4,157	3,387

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 Operational Risk 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 Board approved policies, which have been developed within the Enterprise Risk Management Framework. Compliance with various internal limits 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 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.

(in thousands of Canadian dollars)	Sep 30 2012 $	Dec 31 2012 $	Mar 31 2013 $	Jun 30 2013 $	Sep 30 2013 $
Interest sensitive					
Total assets	1,368,664	1,473,703	1,463,506	1,482,242	1,610,000
Total liabilities and equity	1,296,377	1,384,053	1,371,751	1,389,914	1,512,676
Total interest rate sensitivity gap	72,287	89,650	91,755	92,328	97,324
Non-interest sensitive					
Total assets	47,383	46,105	43,350	44,597	45,301
Total liabilities and equity	119,670	135,755	135,105	136,925	142,625
Total interest rate sensitivity gap	(72,287)	(89,650)	(91,755)	(92,328)	(97,324)

TABLE 14. Interest rate risk (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)	Sep 30 2012 $	Dec 31 2012 $	Mar 31 2013 $	Jun 30 2013 $	Sep 30 2013 $
Before-tax impact on net income of:					
100 bps increase in interest rates	228	237	196	51	51
100 bps decrease in interest rates	(228)	(237)	(196)	(51)	(51)

Interim disclosures

The following summarizes the Bank's interim transitional and all-in capital Basel III Pillar 3 disclosures as at September 30, 2013:

	(in thousands of Canadian dollars)	*ALL-IN BASIS*	*TRANSITIONAL BASIS*
	Common Equity Tier 1 capital: instruments and reserves		
1	Directly issued qualifying common share capital (and equivalent for non-joint stock	129,262	129,262
2	Retained earnings	(27,262)	(27,262)
3	Accumulated other comprehensive income (and other reserves)		
4	Common share capital issued by subsidiaries and held by third parties (amount		
	Common Equity Tier 1 capital: regulatory adjustments		
5	Regulatory adjustments applied to Common Equity Tier 1 under Basel 3	1,096	584
6	Common Equity Tier 1 capital (CET1)	100,904	101,416
	Additional Tier 1 capital: instruments		
7	Directly issued qualifying Additional Tier 1 instruments plus related stock surplus		
8	Directly issued capital instruments subject to phase out from Additional Tier 1		
9	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)		
10	*of which: instruments issued by subsidiaries subject to phase out*		
	Additional Tier 1 capital: regulatory adjustments		
11	Regulatory adjustments applied to Additional Tier 1 under Basel 3		
12	Additional Tier 1 capital (AT1)	0	0
13	Tier 1 capital (T1 = CET1 + AT1)	100,904	101,416
	Tier 2 capital: instruments and provisions		
14	Directly issued qualifying Tier 2 instruments plus related stock surplus	24,975	24,975
15	Directly issued capital instruments subject to phase out from Tier 2		
16	Tier 2 instruments (and CET1 and AT1 instruments not included in rows 5 or 34)		
17	*of which: instruments issued by subsidiaries subject to phase out*		
18	Provisions	3,579	3,579
	Tier 2 capital: regulatory adjustments		
19	Regulatory adjustments applied to Tier 2 under Basel 3		
20	Tier 2 capital (T2)	28,554	28,554
21	Total capital (TC = T1 + T2)	129,458	129,970
22	Total risk weighted assets	774,146	774,658
	Capital ratios		
26	Common Equity Tier 1 (as a percentage of risk weighted assets)	13.03%	13.09%
27	Tier 1 (as a percentage of risk weighted assets)	13.03%	13.09%
28	Total capital (as a percentage of risk weighted assets)	16.72%	16.78%
	National target – All-in Basis		
29	National Common Equity Tier 1 minimum ratio (if different from Basel 3 minimum)		
	Capital instruments subject to phase-out arrangements		
30	*Current cap on CET1 instruments subject to phase out arrangements*		
31	*Amount excluded from CET1 due to cap (excess over cap after redemptions and*		
32	*Current cap on AT1 instruments subject to phase out arrangements*		
33	*Amount excluded from AT1 due to cap (excess over cap after redemptions and*		
34	*Current cap on T2 instruments subject to phase out arrangements*		
35	*Amount excluded from T2 due to cap (excess over cap after redemptions and*		