

## MANAGEMENT'S DISCUSSION AND ANALYSIS

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# Management's Discussion and Analysis

*This Management's Discussion and Analysis (MD&A) is provided to enable readers to assess the financial condition and results of operations of Home Capital Group Inc. (the "Company" or "Home Capital") for the year ended December 31, 2018. The discussion and analysis relates principally to the Company's subsidiary Home Trust Company (Home Trust), which provides residential mortgage lending, non-residential commercial mortgage lending, consumer and credit card lending and deposit-taking services. Home Trust includes its wholly owned subsidiary, Home Bank. This MD&A should be read in conjunction with the audited consolidated financial statements and accompanying notes for the year ended December 31, 2018 included in this report. This MD&A has been prepared with reference to the audited consolidated financial statements, which are prepared in accordance with International Financial Reporting Standards ("IFRS" or "GAAP") and all amounts are presented in Canadian dollars. This MD&A is current as of February 21, 2019. As in prior years, the Company's Audit Committee reviewed this document, and prior to its release the Company's Board of Directors (Board) approved it, on the Audit Committee's recommendation. The Non-GAAP Measures used in this MD&A and a glossary of terms used in this MD&A and the financial statements are presented in the last section of this MD&A.*

*The Company's continuous disclosure materials, including interim filings, annual Management's Discussion and Analysis and audited consolidated financial statements, Annual Information Form, Notice of Annual Meeting of Shareholders and Proxy Circular are available on the Company's website at [www.homecapital.com](http://www.homecapital.com), and on the Canadian Securities Administrators' website at [www.sedar.com](http://www.sedar.com).*

## Caution Regarding Forward-looking Statements

From time to time Home Capital Group Inc. makes written and verbal forward-looking statements. These are included in the Annual Report, periodic reports to shareholders, regulatory filings, press releases, Company presentations and other Company communications. Forward-looking statements are made in connection with business objectives and targets, Company strategies, operations, anticipated financial results and the outlook for the Company, its industry, and the Canadian economy. These statements regarding expected future performance are "financial outlooks" within the meaning of National Instrument 51-102. Please see the risk factors, which are set forth in detail in the Risk Management section of this report, as well as the Company's other publicly filed information, which is available on the System for Electronic Document Analysis and Retrieval (SEDAR) at [www.sedar.com](http://www.sedar.com), for the material factors that could cause the Company's actual results to differ materially from these statements. These risk factors are material risk factors a reader should consider, and include credit risk, liquidity and funding risk, structural interest rate risk, operational risk, investment risk, strategic risk, reputational risk, compliance risk and capital adequacy risk along with additional risk factors that may affect future results. Forward-looking statements can be found in the Report to the Shareholders and the Outlook section in the Annual Report. Forward-looking statements are typically identified by words such as "will," "believe," "expect," "anticipate," "intend," "should," "estimate," "plan," "forecast," "may," and "could" or other similar expressions.

By their very nature, these statements require the Company to make assumptions and are subject to inherent risks and uncertainty, general and specific, which may cause actual results to differ materially from the expectations expressed in the forward-looking statements. These risks and uncertainties include, but are not limited to, global capital market activity, changes in government monetary and economic policies, changes in interest rates, inflation levels and general economic conditions, legislative and regulatory developments, competition and technological change. The preceding list is not exhaustive of possible factors.

These and other factors should be considered carefully and readers are cautioned not to place undue reliance on these forward-looking statements. The Company presents forward-looking statements to assist shareholders in understanding the Company's assumptions and expectations about the future that are relevant in management's setting of performance goals, strategic priorities and outlook. The Company presents its outlook to assist shareholders in understanding management's expectations on how the future will impact the financial performance of the Company. These forward-looking statements may not be appropriate for other purposes. The Company does not undertake to update any forward-looking statements, whether written or verbal, that may be made from time to time by it or on its behalf, except as required by securities laws.

Assumptions about the performance of the Canadian economy in 2019 and its effect on Home Capital's business are material factors the Company considers when setting strategic priorities and outlook. In determining expectations for economic growth, both broadly and in the financial services sector, the Company primarily considers historical and forecasted economic data provided by the Canadian government and its agencies and other third-party providers. In setting and reviewing its strategic priorities and outlook for 2019, management continues to assume:

- > The Canadian economy is expected to be relatively stable in 2019. However, it will continue to be influenced by economic conditions in the United States and global markets, including the impact from the renegotiated trade agreement with the United States and Mexico and from other global trade relations; the Company is prepared for potential volatility.
- > Stable employment conditions in the Company's established regions. Also, the Company expects inflation will generally be within the Bank of Canada's target of 1% to 3%, leading to stable credit losses and demand for the Company's lending products in its established regions.
- > The Bank of Canada may continue to raise its overnight interest rate in 2019 dependent on economic circumstances.

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- > Current and expected levels of housing activity indicate a relatively stable real estate market overall and in particular for the Company's key Greater Toronto Area (GTA) market. Please see Market Conditions under the 2019 Outlook for more discussion on the Company's expectations for the housing market.
- > Debt service levels of Canadian households will remain manageable in 2019; however, high levels of consumer debt make the economy more vulnerable to higher interest rates and any economic weakness.
- > Access to the mortgage and deposit markets through broker networks will be maintained.

## Business Profile

Home Capital is a holding company that operates primarily through its principal, federally regulated subsidiary, Home Trust, which offers deposits, residential and non-residential commercial mortgage lending and consumer lending. Home Trust also conducts business through its wholly owned subsidiary, Home Bank. The Company's former subsidiary, Payment Services Interactive Gateway Inc. (PSiGate), provided payment services. On February 1, 2018, the Company closed the sale of its payment processing and prepaid card business including PSiGate. Please see Note 22 of the consolidated financial statements included in this report for more information. Licensed to conduct business across Canada, Home Trust and Home Bank have offices in Ontario, Alberta, British Columbia, Nova Scotia, Quebec and Manitoba. Business is primarily conducted in Canadian dollars.

### Business Portfolios

The Company's management views the business as a single business with separately identified lending portfolios, deposits and other activities, as described below.

### Mortgage Lending

#### Traditional Single-family Residential Lending

The traditional single-family residential portfolio is the Company's "Classic" mortgage portfolio which consists of primarily uninsured mortgages with loan-to-value ratios of 80% or less, serving selected segments of the Canadian financial services marketplace that are not the focus of the major financial institutions. These mortgages are generally funded by the Company's deposits.

#### Insured Residential Lending

Insured residential lending includes the Company's insured single-family Accelerator mortgages and insured securitized multi-unit residential mortgages. These mortgages are generally funded through Canada Mortgage and Housing Corporation (CMHC) sponsored mortgage-backed security (MBS) and Canada Mortgage Bond (CMB) securitization programs. In some cases, these mortgage portfolios may be sold off-balance sheet, resulting in recognition of gains on sale. The Company remains responsible for the administration of these mortgages and includes them in loans under administration.

#### Residential Commercial Lending (including loans held for sale)

This portfolio comprises insured and uninsured residential commercial lending, which includes commercial mortgages that are secured by residential property such as non-securitized multi-unit residential mortgages and builders' inventory. Insured multi-unit residential mortgages are included in this portfolio until they are securitized. These loans are funded by deposits.

#### Non-residential Commercial Lending

Non-residential commercial lending includes store and apartment mortgages and commercial mortgages. These loans are funded by deposits.

### Consumer Lending

#### Credit Card and Line of Credit Lending

The Company's Equityline Visa product, which is a home equity line of credit (HELOC) secured by residential property, currently represents more than 80% of balances receivable for the credit card loans and lines of credit. The Company also offers cash-secured and unsecured credit card products. Credit card loans and lines of credit are funded by deposits.

#### Other Consumer Retail Lending

This portfolio primarily includes consumer retail lending for durable household goods, such as water heaters and larger-ticket home improvement items. Consumer loans are supported by holdbacks or guarantees from the distributors of such items and/or collateral charges on real property. Consumer loans are both originated directly and as cash flow payment streams via other loans and rental contract originators. Consumer loans are funded with deposits.

## Deposits

The Company's uninsured assets are largely funded by its deposit activities. Deposits are generally taken for fixed terms, varying from 30 days to five years and carry fixed rates of interest over the full term of the deposit. The Company also has certain deposit diversification strategies, including growing the Oaken Financial direct-to-consumer deposit brand. Home Trust and Home Bank deposits are offered through both brokers and Oaken Financial. Home Trust and Home Bank are both members of the Canada Deposit Insurance Corporation (CDIC) and their retail deposits are eligible for CDIC coverage, up to the applicable limits.

## Other Activities

In addition to its lending portfolios, the Company manages a treasury portfolio to support liquidity requirements and invest excess capital. The Company's operations also included PSiGate, the sale of which was closed on February 1, 2018 as indicated above. In addition, Home Trust's subsidiary Home Bank, a Canadian retail bank, offers deposits and mortgages.

As management views its business as a single segment with a variety of product and service activities, the financial statements and the MD&A are prepared on that basis.

## 2019 Outlook

The Company's priorities are to position the business for long-term leadership in the alternative lending industry within the framework of a sustainable risk culture. To achieve this, management is focused on offering competitive products, increasing outreach in the broker community and enhancing service experience through technological innovation and process re-engineering. The Company has undertaken a multi-year plan of investment in systems and technology (the "IT Roadmap") to improve productivity and customer service for the long term.

## Market Conditions

In 2018, market conditions in the Company's established regions were impacted by higher interest rates and regulatory and government actions intended to moderate the rapid house price increases of recent years. The Company believes that current market conditions suggest a balanced and sustainable real estate market going forward, supported by healthy and rational levels of competition. The Company expects stable employment conditions, high immigration targets and relatively tight housing supply to continue to provide support to the Company's primary markets.

## Traditional Single-family Mortgage Lending

The Company expects that focus on service for 2019 will allow the Company to continue to improve traditional mortgage origination volumes within its established regions.

## Insured Securitized Mortgage Lending

The Company will continue to originate and securitize prime insured single-family and insured multi-unit residential mortgages and will generally sell the insured multi-unit residential mortgages off-balance sheet, generating gains on sale. The market for both products remains very competitive and the Company expects that new origination levels and spreads will be impacted by this level of competition. The Company remains committed to offering a range of mortgage products through its distribution channel.

## Commercial Mortgage Lending

Commercial mortgage lending will remain an important portfolio for the Company, contributing high yields and providing asset diversification. The Company continues to grow the non-residential commercial portfolio. The Company expects increased competition in this market which may drive down yields in this portfolio.

## Consumer Lending

Credit cards and other consumer retail loans remain important complementary product offerings supporting the Company's lending strategy.

### Net Interest Margin

The Company's net interest margin in 2018 was negatively impacted by increased funding costs resulting from increases in market interest rates over the past year, without a commensurate increase in mortgage interest rates. Net interest margin in 2019 will be impacted by higher rates on deposits issued in the latter part of 2018 to raise funds to support the repurchase of \$300 million of the Company's common shares under the Company's substantial issuer bid (SIB) and repayment of institutional deposit notes in December 2018. Net interest margins in 2019 may continue to be impacted by further rate activity. Net interest margin will continue to benefit from the \$500 million reduced standby credit facility relative to the previous \$2 billion facility that was in place during the first half of 2018.

The Company is prepared for modest volatility in its net interest margin which may be impacted by Bank of Canada interest rate changes, improving credit quality of the uninsured residential mortgage portfolio resulting from regulatory changes and increased competition from other lenders, among other variables.

### Credit Performance and Losses

The Company's prudent underwriting and collection practices are reflected by the low levels of credit losses and delinquencies in its loan portfolios. Credit losses and delinquencies are expected to remain low in 2019; however, the Company is prepared for volatility in this performance that may result from uncertainty in the macroeconomic environment.

The allowance for credit losses, as determined under IFRS 9, is sensitive to the inputs used in models, including macroeconomic variables in the forward-looking scenarios and their respective probability weightings, among other factors. This may add significant volatility to reported credit losses.

### Non-interest Expenses

It is expected that salaries and benefits will increase in line with an increase in the number of employees along with normal merit and cost of living increases. Some of the expected increase in number of employees will result from additional resources needed to support the IT Roadmap. The lingering impact of certain costs stemming from the liquidity event in 2017 is expected to continue through 2019. In addition, it is expected that non-interest expenses will be higher than normal until the conclusion of the IT Roadmap. Contributing to the higher level of expense will be accelerated amortization of internally developed software currently in use that will be replaced with software being developed under the IT Roadmap.

### Deposits

The Company will continue to source deposits from the public through investment dealers and deposit brokers and will continue to emphasize growth of its direct-to-consumer business, Oaken Financial. The Company intends to maintain demand deposits to an appropriate level that is aligned with the Company's liquidity and funding requirements as well as its risk appetite.

### Liquidity and Capital

In December 2018, the Company completed the previously announced SIB resulting in the repurchase of \$300 million of its common shares. A total of 18,181,818 common shares were repurchased under the SIB representing 22.7% of the issued and outstanding shares prior to the repurchase. The Company continues to hold high levels of capital as measured by regulatory risk-based capital ratios and leverage ratios. The Company will continue to employ robust capital adequacy stress-testing techniques to ensure that its conservative capital position is maintained and provide for the flexibility to take advantage of appropriate market opportunities as they arise.

As previously announced, the Company implemented a Normal Course Issuer Bid, effective January 2, 2019. The Company will continue to review opportunities to optimize its capital structure. The Company expects capital ratios will remain in excess of both regulatory and internal capital targets.

The Company will continue to diversify its funding sources and maintain a strong liquidity position by holding a sufficient stock of unencumbered high-quality liquid assets.

**This Outlook section contains forward-looking statements. Please see the Caution Regarding Forward-looking Statements in this report.**

# Financial Highlights

**Table 1: Key Performance Indicators**

For the years ended December 31

(000s, except %, multiples and per share amounts)

	2018	2017	2016	2015	2014
<b>FINANCIAL PERFORMANCE MEASURES<sup>1</sup></b>					
Total revenue	\$ 418,852	\$ 291,311	\$ 581,959	\$ 584,883	\$ 592,888
Net income	132,603	7,527	247,396	287,285	313,172
Net interest income	352,400	302,930	485,164	481,090	459,529
Earnings per share – basic	1.66	0.10	3.71	4.09	4.48
Earnings per share – diluted	1.66	0.10	3.71	4.09	4.45
Dividends per share	—	0.26	0.98	0.88	0.70
Return on shareholders' equity	7.7%	0.4%	15.1%	18.5%	23.8%
Return on average assets	0.7%	0.0%	1.2%	1.4%	1.6%
Net interest margin (TEB) <sup>2</sup>	1.99%	1.55%	2.37%	2.36%	2.25%
Net interest margin non-securitized assets (TEB) <sup>2</sup>	2.37%	1.80%	2.73%	2.83%	2.83%
Net interest margin CMHC-sponsored securitized assets	0.42%	0.48%	0.47%	0.49%	0.67%
Efficiency ratio (TEB) <sup>2</sup>	52.0%	94.0%	40.8%	32.4%	27.2%
<b>FINANCIAL CONDITION MEASURES<sup>1</sup></b>					
Total assets	\$ 18,141,689	\$ 17,591,143	\$ 20,528,777	\$ 20,527,062	\$ 20,082,744
Total assets under administration <sup>3</sup>	24,680,225	25,040,182	28,917,534	27,316,476	24,281,366
Cash and securities-to-total assets	5.8%	9.5%	8.5%	7.8%	4.7%
Total loans <sup>4</sup>	\$ 16,394,738	\$ 15,069,636	\$ 18,038,518	\$ 18,271,190	\$ 18,367,013
Total loans under administration <sup>3,4</sup>	22,933,274	22,518,675	26,427,275	25,060,604	22,565,635
Common Equity Tier 1 capital ratio <sup>5</sup>	18.94%	23.17%	16.55%	18.31%	18.30%
Tier 1 capital ratio <sup>5</sup>	18.93%	23.17%	16.54%	18.30%	18.30%
Total capital ratio <sup>5</sup>	19.38%	23.68%	16.97%	20.70%	20.94%
Assets to regulatory capital multiple <sup>5,6</sup>	N/A	N/A	N/A	N/A	12.47
Leverage ratio <sup>5,6</sup>	7.54%	8.70%	7.20%	7.36%	N/A
Credit quality					
Provision for credit losses as a % of gross loans	0.13%	0.05%	0.04%	0.05%	0.07%
Net non-performing loans as a % of gross loans	0.47%	0.30%	0.30%	0.28%	0.30%
Allowance as a % of gross non-performing loans	54.0%	79.5%	73.4%	74.0%	64.4%

<sup>1</sup> The amounts pertaining to 2018 have been prepared in accordance with IFRS 9 *Financial Instruments* (IFRS 9); prior period amounts have not been restated and have been prepared in accordance with IAS 39 *Financial Instruments: Recognition and Measurement* (IAS 39). Please see Note 2 in the audited consolidated financial statements included in this report for further information.

<sup>2</sup> See definition of Taxable Equivalent Basis (TEB) under Non-GAAP Measures in this report.

<sup>3</sup> Total assets and loans under administration include both on- and off-balance sheet amounts.

<sup>4</sup> Total loans include loans held for sale and are presented gross of allowance for credit losses for all periods presented.

<sup>5</sup> These figures relate to the Company's operating subsidiary, Home Trust Company.

<sup>6</sup> Effective Q1 2015, the Assets to Regulatory Capital Multiple was replaced with the Basel III leverage ratio. See definition of Leverage Ratio under Non-GAAP Measures in this report.

### Income Statement Summary for 2018

- > Net income was \$132.6 million in 2018 compared to \$7.5 million in 2017. Net income in 2017 was significantly lower as a result of the impact of the liquidity event that occurred in the second quarter of 2017.
- > Diluted earnings per share of \$1.66 increased from \$0.10 in 2017, primarily reflecting the increase in net income noted above.
- > Return on average shareholders' equity of 7.7% for 2018 increased from 0.4% for 2017, also reflecting the increase in net income.
- > Total net interest income of \$352.4 million increased \$49.5 million or 16.3% from \$302.9 million in 2017. Net interest income in 2017 was significantly impacted by interest and fees on the line of credit facilities drawn upon as a result of the liquidity event, which included an emergency line of credit and a subsequent \$2 billion credit facility from a subsidiary of Berkshire Hathaway Inc. that was used to repay the emergency line of credit. Interest and fees on these facilities included a \$100 million commitment fee on the emergency line of credit along with interest expense on amounts drawn on both facilities.
- > Total net interest margin (TEB) improved to 1.99% in 2018 from 1.55% in 2017, while non-securitized net interest margin (TEB) improved to 2.37% in 2018 from 1.80% in 2017. The net interest margins in 2017 were negatively impacted by the interest and fees on the line of credit facilities referred to above. The improvement in net interest margin attributable to the reduction in interest and fees on credit facilities was largely offset by the impact of increased funding costs resulting from increases in market interest rates without a commensurate increase in mortgage rates.
- > Total income earned from securitization includes both net interest income on securitized assets and securitization income arising from sales of securitized assets. Combined net interest income on securitized assets and securitization income was \$24.4 million for the year, compared to \$29.0 million in 2017. The decrease resulted from both lower net interest margin and lower securitization income. The decrease in securitization income resulted from the absence of sales of residual interests of underlying securitized insured single-family residential mortgages in 2018 as the Company is retaining such residual interests.
- > Non-interest income was \$66.5 million in 2018 compared to a non-interest loss of \$11.6 million in 2017. The non-interest loss in 2017 resulted from a loss on sale of securities and loans, which were sold following the liquidity event in 2017.
- > The credit quality of the loan portfolio remains strong, with continued low credit losses and non-performing loans. Provisions for credit losses were 0.13% of gross loans compared to 0.05% in 2017. Net non-performing loans as a percentage of gross loans were 0.47% at the end of 2018, compared to 0.30% at the end of 2017. The provision for credit losses in 2018 reflects the adoption of the expected credit loss impairment approach of IFRS 9 in 2018, which replaced the previous incurred loss approach used prior to 2018.
- > Non-interest expenses, which include salaries, premises and other operating expenses, were \$218.1 million in 2018, down 20.7% from the \$274.9 million recorded in 2017. The higher expenses in 2017 included \$12.8 million of impairment losses on intangible assets and goodwill, \$13.2 million of restructuring provisions related to the Project EXPO expense savings initiative, \$7.0 million of costs relating to the Ontario Securities Commission (OSC) and class action matters that were not covered by the Company's insurers and elevated costs associated with the liquidity event. In addition, a decline in the average number of employees resulting from the impact of Project EXPO and voluntary attrition following the liquidity event contributed to the decrease in salaries and benefits expense. The Company's efficiency ratio (TEB) decreased to 52.0% in 2018 from 94.0% in 2017 reflecting the decrease in expenses and increased revenue.



## Financial Position Summary for 2018

- > Total assets under administration, which includes \$6.54 billion of mortgages accounted for off-balance sheet, were \$24.68 billion, a decrease of \$360.0 million or 1.4% from \$25.04 billion in 2017, resulting primarily from a decrease in cash balances following the repurchase of common shares under the Company's SIB and the repayment of institutional deposit notes that matured towards the end of the year.
- > Total loans under administration increased to \$22.93 billion from \$22.52 billion at the end of 2017, resulting from an increase in the on-balance sheet portfolio reflecting improved mortgage originations and retention, offset partially by a decrease in the off-balance sheet single-family residential mortgage portfolio. The decrease in the single-family residential mortgage off-balance sheet portfolio has resulted from the Company retaining its residual interests in securitized insured single-family residential mortgages and the resulting absence of sales and corresponding derecognition from the balance sheet.
- > Mortgage originations were \$5.44 billion in 2018, compared to the \$4.72 billion originated in 2017, an increase of 15.2%. The increase resulted primarily from traditional single-family residential mortgage originations, which increased to \$3.76 billion in 2018 from \$3.06 billion in 2017. Single-family residential mortgage originations continued to represent the Company's primary focus, with traditional mortgage originations accounting for 69.1% of originations and Accelerator (insured) residential mortgage originations accounting for 4.3% of originations. Residential commercial and non-residential commercial mortgage originations made up the remaining 26.6% of the originations.
- > Liquid assets at December 31, 2018 were \$1.29 billion, compared to \$1.65 billion at December 31, 2017. The Company maintains a prudent level of liquidity, given the current level of operations and the Company's obligations including the maturity profile of these obligations.
- > The credit quality of the loan portfolio remains strong with continued low non-performing loans as indicated previously.
- > Deposits were \$12.98 billion, up from \$12.17 billion at December 31, 2017. Deposits raised through the Company's direct-to-consumer brand, Oaken Financial represented 20.7% of total deposits at the end of 2018 compared to 16.7% at the end of 2017.
- > Securitization liabilities were \$2.86 billion at the end of 2018, down from \$3.18 billion last year, resulting from CMB maturities and a decline in bank-sponsored securitization conduit liabilities as the conduit facility has not been available since the first half of 2017.
- > Shareholders' equity at the end of 2018 decreased to \$1.64 billion from \$1.81 billion at the end of last year, resulting from the repurchase of \$300 million of common shares under the Company's SIB at the end of the year.
- > Home Trust's capital levels were strong throughout 2018, as indicated by the Common Equity Tier 1 Capital ratio of 18.94% and the Tier 1 and Total capital ratios of 18.93% and 19.38%, respectively, at December 31, 2018. Home Trust's Leverage ratio ended 2018 at 7.54%. The capital ratios decreased from the end of 2017 as a result of a combination of reduced capital and an increase in risk-weighted assets. The reduction in Home Trust regulatory capital resulted from the declaration of dividends from Home Trust to the Company in support of the SIB. The increase in risk-weighted assets reflects growth in the mortgage portfolio.



## Financial Performance Review

**Table 2: Income Statement Summary**

(000s, except per share amounts)	2018	2017
Net interest income non-securitized assets <sup>1</sup>	\$ 338,554	\$ 286,412
Net interest income securitized loans and assets <sup>1</sup>	13,846	16,518
Total net interest income <sup>1</sup>	352,400	302,930
Provision for credit losses <sup>1</sup>	20,377	7,516
	332,023	295,414
Non-interest income (loss)	66,452	(11,619)
Non-interest expenses	218,073	274,880
Income before income taxes	180,402	8,915
Income taxes	47,799	1,388
Net income	\$ 132,603	\$ 7,527
Basic earnings per share	\$ 1.66	\$ 0.10
Diluted earnings per share	\$ 1.66	\$ 0.10

<sup>1</sup> The amounts pertaining to 2018 have been prepared in accordance with IFRS 9; prior period amounts have not been restated and have been prepared in accordance with IAS 39. Please see Note 2 to the audited consolidated financial statements included in this report for further information.

### Net Interest Income and Margin

Presented in Tables 3 and 4 are analyses of average rates, net interest income and net interest margin. Net interest income is the difference between interest and dividends earned on loans and investments and the interest paid on deposits and borrowings to fund those assets. The net interest margin is net interest income divided by the Company's average total assets. Dividend income has been converted to TEB (refer to the Non-GAAP Measures and Glossary section of this report for a definition of TEB) for comparison purposes.

**Table 3: Net Interest Margin**

	2018	2017
Net interest margin non-securitized interest-earning assets (non-TEB)	2.37%	1.79%
Net interest margin non-securitized interest-earning assets (TEB)	2.37%	1.80%
Net interest margin CMHC-sponsored securitized assets	0.42%	0.48%
Net interest margin bank-sponsored securitization conduit assets	1.43%	1.37%
Total net interest margin (non-TEB)	1.99%	1.54%
<b>Total net interest margin (TEB)</b>	<b>1.99%</b>	<b>1.55%</b>
Spread of non-securitized loans over deposits and credit facilities	2.41%	1.96%

Total net interest margin (TEB), including the securitized portfolio, was 1.99% for 2018 compared to 1.55% in 2017. Net interest margin in 2017 was significantly impacted by interest and fees on the credit facilities that were drawn upon in connection with the liquidity event experienced in 2017. Interest and fees on line of credit facilities were \$148.2 million in 2017. Included in the interest and fees on these facilities was a \$100 million commitment fee along with interest expense on drawn amounts and standby fees on undrawn amounts. To raise liquidity following the liquidity event, the Company also sold higher-yielding assets, including both securities and mortgages. These asset sales also contributed to the reduction in net interest margins.

The improvement in net interest margin in 2018 over last year primarily reflects the reduction in interest and fees on credit facilities from the significant amount indicated above. The Company did not draw on its standby credit facilities during 2018 thereby incurring no interest on drawn amounts. At the end of the second quarter of 2018, the Company replaced its \$2 billion standby credit facility with a \$500 million facility, substantially reducing the standby fee. The resulting interest and fees on credit facilities for 2018 was \$17.3 million, significantly lower than the \$148.2 million noted above. Also contributing to the improvement in net interest margin was a reduction in total cash and securities and improved yields on those assets. The decline in cash balances reflects actions taken by the Company to better align its liquidity position to its liquidity and funding requirements. While net interest margins improved over 2017, margins in 2018 were negatively impacted by increased funding costs resulting from increases in market interest rates over the past year without a commensurate increase in mortgage rates.

**Table 4: Net Interest Income by Product and Average Rate**

	2018			2017		
	Average Balance <sup>1</sup>	Income/Expense	Average Rate <sup>1</sup>	Average Balance <sup>1</sup>	Income/Expense	Average Rate <sup>1</sup>
<b>Assets</b>						
Cash resources and securities	\$ 1,631,437	\$ 25,990	1.59%	\$ 1,952,735	\$ 18,384	0.94%
Traditional single-family residential mortgages	9,933,571	477,612	4.81%	10,925,088	514,562	4.71%
Accelerator single-family residential mortgages	505,482	16,109	3.19%	498,078	13,974	2.81%
Residential commercial mortgages <sup>2</sup>	255,908	11,527	4.50%	272,029	13,173	4.84%
Non-residential						
commercial mortgages	1,256,999	75,823	6.03%	1,616,847	97,421	6.03%
Credit card loans and lines of credit	370,878	32,420	8.74%	373,186	33,328	8.93%
Other consumer retail loans	342,286	30,879	9.02%	380,588	38,468	10.11%
Total non-securitized loans	12,665,124	644,370	5.09%	14,065,816	710,926	5.05%
Taxable equivalent adjustment	—	455	—	—	1,125	—
Total non-securitized assets	14,296,561	670,815	4.69%	16,018,551	730,435	4.56%
CMHC-sponsored securitized single-family residential mortgages	2,342,802	65,683	2.80%	2,213,217	52,053	2.35%
CMHC-sponsored securitized multi-unit residential mortgages	509,234	24,166	4.75%	586,338	30,782	5.25%
Assets pledged as collateral for CMHC-sponsored securitization	120,949	1,550	1.28%	80,452	943	1.17%
Total CMHC-sponsored securitized residential mortgages	2,972,985	91,399	3.07%	2,880,007	83,778	2.91%
Bank-sponsored securitization conduit assets	95,289	3,138	3.29%	191,177	6,151	3.22%
Other assets	389,190	—	—	498,554	—	—
<b>Total Assets</b>	<b>\$ 17,754,025</b>	<b>\$ 765,352</b>	<b>4.31%</b>	<b>\$ 19,588,289</b>	<b>\$ 820,364</b>	<b>4.19%</b>
<b>Liabilities and Shareholders' Equity</b>						
Deposits and credit facilities	\$ 12,390,325	\$ 331,806	2.68%	\$ 14,322,507	\$ 442,898	3.09%
CMHC-sponsored securitization liabilities	2,987,798	78,915	2.64%	2,897,462	69,872	2.41%
Bank-sponsored securitization conduit liabilities	88,521	1,776	2.01%	188,500	3,539	1.88%
Other liabilities and shareholders' equity	2,287,381	—	—	2,179,820	—	—
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$ 17,754,025</b>	<b>\$ 412,497</b>	<b>2.32%</b>	<b>\$ 19,588,289</b>	<b>\$ 516,309</b>	<b>2.64%</b>
<b>Net Interest Income (TEB)</b>		<b>\$ 352,855</b>			<b>\$ 304,055</b>	
<b>Taxable Equivalent Adjustment</b>		<b>(455)</b>			<b>(1,125)</b>	
<b>Net Interest Income per Financial Statements</b>		<b>\$ 352,400</b>			<b>\$ 302,930</b>	

<sup>1</sup> The average is calculated with reference to opening and closing monthly asset and liability and shareholders' equity balances.

<sup>2</sup> Residential commercial mortgages include non-securitized multi-unit residential mortgages and commercial mortgages secured by residential property types.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Total net interest income of \$352.4 million increased \$49.5 million or 16.3% over \$302.9 million in 2017 primarily resulting from an increase of \$52.1 million in non-securitized net interest income to \$338.6 million from \$286.4 million in 2017. Securitized net interest income of \$13.8 million in 2018 decreased from \$16.5 million in 2017, partially offsetting the increase in non-securitized net interest income.

The improvement in non-securitized net interest income reflects an improvement in non-securitized net interest margin (TEB) to 2.37% in 2018 from 1.80% in 2017 and resulted primarily from the reduction in interest and fees on credit facilities discussed above. However, as previously noted, net interest margin was negatively impacted by increasing funding costs outpacing mortgage rates. In addition, the reduction in asset balances resulting from loans and securities sold last year in response to the liquidity event, combined with the decline in originations following the liquidity event, caused a decline in the asset base. While the Company was successful in re-building its mortgage portfolio through 2018, total non-securitized interest income, including dividends, declined to \$670.4 million in 2018 from \$729.3 million in 2017. Despite this decline in interest income, interest expense on deposits in 2018 increased to \$314.5 million from \$294.7 million in 2017. The increase in interest expense on deposits reflects the increase in market interest rates combined with an increase in deposit balances during the year. The increase in deposit balances reflects the higher liquidity levels that were being held in the earlier part of 2018 combined with increased deposit inflows in the second half of the year to fund the Company's repurchase of shares under its SIB and repayment of institutional deposit notes in December.

The decrease in net interest income on securitized assets from 2017 reflects the decrease in net interest margin on CMHC-sponsored securitized assets to 0.42% from 0.48% last year.

### Non-Interest Income (Loss)

**Table 5: Non-interest Income (Loss)**

(000s)		2018		2017
Fees and other income	\$	47,806	\$	67,932
Securitization income		10,540		12,529
Gain on sale of PSiGate		950		—
Net realized and unrealized gains (losses) on securities and loans		5,467		(90,070)
Net realized and unrealized gains (losses) on derivatives		1,689		(2,010)
	\$	66,452	\$	(11,619)

**Table 6: Securitization Income**

(000s)		2018		2017
Net gain on sale of mortgages and residual interest <sup>1</sup>	\$	4,633	\$	5,695
Net change in unrealized gain or loss on hedging activities		8		(247)
Servicing income		5,899		7,081
Total securitization income	\$	10,540	\$	12,529

<sup>1</sup> Gain on sale of mortgages and residual interest are net of hedging impact.

Non-interest income was \$66.5 million in 2018 compared to a non-interest loss of \$11.6 million in 2017. The non-interest loss in 2017 resulted primarily from the recognition of \$90.1 million of net losses on the sale of securities and loans during the year. These asset sales were made to raise liquidity following the liquidity event of 2017. Included in non-interest income in 2018 are gains of \$1.0 million on the sale of debt securities and \$4.5 million of recovery of losses on the commercial mortgages sold last year. The decrease in fees and other income from last year reflects the sale of the Company's PSiGate and prepaid card business in Q1 2018. The associated decrease in expenses resulting from the sale of this business substantially reduced the impact on the Company's net income.

Securitization income results primarily from gains recognized on the sale of insured multi-unit residential mortgages and the sale of residual interests in single-family residential mortgage securitizations along with income earned on servicing mortgages sold through securitization. In the case of single-family residential mortgage sales, the Company will service the loans and record related servicing fee revenue over the remaining term of the underlying mortgages. In the case of multi-unit residential mortgages, the Company outsources the servicing activity and no further net servicing revenue or fees are recorded. Securitization income for the year resulted primarily from servicing income of \$5.9 million, compared to \$7.1 million last year. Securitization income also included gains of \$4.6 million recorded on sales of \$650.7 million of insured multi-unit residential mortgages in 2018 compared to gains of \$5.7 million recorded on sales of \$799.3 million of both insured multi-unit residential mortgages and residual interests in single-family residential mortgage securitizations last year. There were no sales of residual interests in 2018. In the near term, the Company does not expect to sell any residual interests. Please see Note 6 to the consolidated financial statements included in this report for further information.

Please see the discussion below on Derivatives and Hedging related to net realized and unrealized loss on derivatives.

## Derivatives and Hedging

The Company enters into derivative transactions primarily to hedge interest rate exposure resulting from outstanding loans held for sale and to hedge interest rate risk on fixed-rate securitization liabilities and deposits. Where appropriate, the Company will apply hedge accounting to minimize volatility in reported earnings from interest rate changes. All derivative contracts are over-the-counter contracts with highly rated Canadian financial institutions. Please see Note 18, Derivative Financial Instruments and Hedging Activities, to the consolidated financial statements included in this report for further information. Table 7 below summarizes the impact of derivatives and hedge accounting on the Company's financial results.

**Table 7: Derivatives Gains and Losses**

(000s)		2018	2017
Fair value hedging ineffectiveness	\$	(410)	\$ (1,482)
Derivative instruments marked-to-market gains (losses) <sup>1</sup>		2,099	(528)
Net realized and unrealized gains (losses) on derivatives	\$	1,689	\$ (2,010)

<sup>1</sup> Included in derivative instruments marked to market are swaps and bond forwards.

## Cash Flow Hedging

The Company uses Government of Canada bond forwards to hedge the impact of movements in interest rates between the time that mortgage commitments are made and the time that those mortgages are funded and/or securitized. Hedges are structured such that the fair value movements of the hedge instruments offset, within a reasonable range, the changes in the fair value of the pool of fixed-rate mortgages due to interest rate fluctuations between commitment and funding. The term of these hedges is generally 60 to 150 days. These hedge instruments are settled or unwound at the time of funding or securitization of the underlying mortgages. The Company applies cash flow hedge accounting to the Government of Canada bond forwards. The intent of hedge accounting is to recognize the effective matching of the gain or loss on the Government of Canada bond forwards with the recognition of the related interest expense on the resulting funding. Cash flow hedge accounting is also applied to total return swaps to hedge the variability in cash flows associated with forecasted share-based compensation obligations attributable to changes in the Company's stock price.

## Fair Value Hedging

The Company is exposed to interest rate risk through fixed-rate financial assets and liabilities and its participation in the CMB program. To hedge these risks, the Company enters into interest rate swaps and applies fair value hedge accounting. The intent of fair value hedge accounting is to have the fair value changes in the interest rate swap offset, within a reasonable range, the changes in the fair value of the fixed-rate borrowing and assets resulting from changes in the interest rate environment. Any unmatched fair value change is recorded in non-interest income as hedge ineffectiveness through net realized and unrealized gain or loss on derivatives.

## Economic Hedge of Loans Held for Securitization and Sale

The Company enters into bond forwards to hedge interest rate risk on loans held for securitization and sale through National Housing Act Mortgage-Backed Securities (NHA MBS) securitization programs. The underlying loans are classified as held for sale for accounting purposes and held at fair value on the balance sheet. The loans are insured mortgages on multi-unit residential properties. The derivatives used to hedge these loans are not designated in hedge accounting relationships. The fair value changes of these derivatives are mostly offset by the fair value changes related to loans held for sale. The fair value changes reflect changes in interest rates. The net unrealized gain for 2018 for fair value changes in both the outstanding derivatives and the loans held for sale was \$8 thousand (2017 – unrealized loss of \$247 thousand), which was recorded in securitization income.

## Other Total Return Swaps

The Company had certain total return swaps that were not designated in hedge accounting relationships and, therefore, were adjusted to fair value without an offsetting hedged amount. These swaps were originally intended as cash flow hedges for issued restricted share units; however, as the associated units were forfeited or cancelled, the swaps were left outside of hedging relationships. Therefore, their fair value change is recorded in non-interest income through net realized and unrealized gain or loss on derivatives.

Please see Note 18 of the consolidated financial statements for further information.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

**Table 8A: Provision for Credit Losses and Net Write-Offs as a Percentage of Gross Loans, Under IFRS 9**

	2018	
	Amount	% of Gross Loans
<b>Provision</b>		
Single-family residential mortgages	\$ 5,480	0.04%
Commercial mortgages	10,392	0.52%
Credit card loans and lines of credit	2,108	0.52%
Other consumer retail loans	2,397	0.75%
Total provision	\$ 20,377	0.13%
<b>Net Write-Offs</b>		
Single-family residential mortgages	\$ 1,874	0.01%
Commercial mortgages	4,134	0.21%
Credit card loans and lines of credit	2,389	0.59%
Other consumer retail loans	565	0.18%
Net write-offs	\$ 8,962	0.06%

**Table 8B: Provision for Credit Losses and Net Write-Offs as a Percentage of Gross Loans, Under IAS 39**

	2017	
	Amount	% of Gross Loans <sup>1</sup>
<b>Provision<sup>2</sup></b>		
Single-family residential mortgages	\$ 1,891	0.02%
Residential commercial mortgages	16	0.01%
Non-residential commercial mortgages	3,196	0.31%
Credit card loans and lines of credit <sup>3</sup>	5,387	1.53%
Other consumer retail loans	526	0.15%
Securitized single-family residential mortgages	—	—
Securitized multi-unit residential mortgages	—	—
Total individual provision	11,016	0.07%
Total collective provision	(3,500)	(0.02)%
Total provision	\$ 7,516	0.05%
<b>Net Write-Offs<sup>2</sup></b>		
Single-family residential mortgages	\$ 2,467	0.02%
Residential commercial mortgages	16	0.01%
Non-residential commercial mortgages	96	0.01%
Credit card loans and lines of credit <sup>3</sup>	5,710	1.62%
Other consumer retail loans	666	0.18%
Securitized single-family residential mortgages	—	—
Securitized multi-unit residential mortgages	—	—
Net write-offs	\$ 8,955	0.06%

<sup>1</sup> Gross loans used in the calculation of total Company ratio include securitized on-balance sheet loans.

<sup>2</sup> There were no individual provisions, allowances or net write-offs on securitized mortgages.

<sup>3</sup> Provision and write-offs for credit card loans in 2017 include \$2.3 million related to the non-core prepaid card business recognized in provision for credit losses in the first quarter of 2017 and subsequently written off in the fourth quarter of 2017.

Provisions for credit losses were calculated under IFRS 9 for 2018 and under IAS 39 for 2017. As provisions for credit losses for 2017 were not restated, comparability is reduced to some extent. Please see Note 5(C) to the consolidated financial statements included in this report for more information on the provision for credit losses and a continuity of the allowance for credit losses for the year. Refer to Note 5(D) to the consolidated financial statements included in this report for a distribution of the gross carrying value of loans by product across five internal risk ratings for each of the IFRS 9 stages.

The Company continues to have strong credit performance with total provision for credit losses of \$20.4 million in 2018. Provision as a percentage of gross uninsured loans remained low at 0.16% compared to 0.07% in 2017. Provision for credit losses for the year resulted primarily from growth in the mortgage portfolio and from specific non-performing commercial loans included in Stage 3 under IFRS 9. A specific commercial loan that was provided for during the year was written off by the end of 2018.

Total provision for credit losses in 2017 included a reduction of \$3.5 million in the collective allowance for credit losses. This reduction resulted from a release of \$6.5 million in the collective allowance for the commercial mortgage portfolio following the sale of mortgages from that portfolio. The release in the collective allowance was offset by a corresponding increase to the loss on the sale of those mortgages included in non-interest income in 2017.

As a part of periodic review and quarterly updates, certain revisions may be made to reflect updates in model-derived loss estimates to incorporate recent loss experience of the Company's credit portfolios and forward-looking assumptions, which may cause a change to the allowance for expected credit losses.

The Company continues to observe strong credit profiles and stable loan-to-value ratios across its portfolio, which continues to support low delinquency and non-performing rates and ultimately low net write-offs. Net write-offs were \$9.0 million and represented 0.06% of gross loans, unchanged from 2017.

Net non-performing loans (represented by Stage 3 loans under IFRS 9) as a percentage of gross loans remained low at 0.47% at the end of 2018 compared to 0.30% at the end of 2017. Non-performing loans were determined under IFRS 9 for 2018 and under IAS 39 for 2017, reducing comparability to some extent. The Company remains satisfied with the credit performance of the portfolio, but is prepared for moderate volatility in the trend. Please see the Credit Risk section of this MD&A for more details.

## Non-Interest Expenses

**Table 9: Non-Interest Expenses**

(000s, except % and number of employees)	2018	2017
Salaries and benefits	\$ 76,924	\$ 98,595
Premises	10,168	13,878
Other operating expenses	130,981	162,407
	<b>\$ 218,073</b>	<b>\$ 274,880</b>
Efficiency Ratio (TEB)	<b>52.0%</b>	94.0%
Average number of active employees during the year	<b>704</b>	793

Non-interest expenses decreased by \$56.8 million or 20.7% from the end of 2017, resulting primarily from decreases in salaries and benefits and other operating expenses. The decrease in expenses combined with higher revenue resulted in an improved efficiency ratio (TEB) of 52.0% compared to 94.0% last year.

Salaries and benefits decreased by \$21.7 million or 22.0% from last year. The decrease in salaries and benefits reflects a decline in the average number of active employees resulting from the impact of Project EXPO and voluntary attrition following the liquidity event. Salary expense in 2017 also included severance expense in connection with Project EXPO.

Other operating expenses decreased by \$31.4 million or 19.4% from last year, as operating expenses in 2017 included write-downs related to goodwill, intangible and other assets within the Company's PSiGate and prepaid card business, along with elevated legal and other professional fees connected with the liquidity event and the OSC and class action matter that occurred in 2017. The decrease in other operating expenses also reflects the sale of the Company's PSiGate and prepaid card business in Q1 2018. Other operating expenses in 2018 included an impairment loss of \$0.5 million and incremental amortization of \$1.1 million related to the Company's internally developed software. Please see Note 9 to the consolidated financial statements included in this report for further information.

## Taxes

**Table 10: Income Taxes**

(000s, except %)	2018	2017
Current	\$ 43,103	\$ (2,475)
Deferred	4,696	3,863
Total income taxes	<b>\$ 47,799</b>	<b>\$ 1,388</b>
Effective income tax rate	<b>26.50%</b>	15.57%

The provision for income taxes for the year ended December 31, 2018 amounted to \$47.8 million, reflecting an effective tax rate of 26.50% (\$1.4 million and 15.57% in 2017).

Note 16 to the consolidated financial statements included in this report provides more information about the Company's current income taxes, deferred income taxes and provision for income taxes.

## Comprehensive Income

**Table 11: Comprehensive Income**

(000s)	2018		2017	
Net income	\$	<b>132,603</b>	\$	7,527
Total other comprehensive (loss) income		<b>(4,591)</b>		49,171
Comprehensive income	\$	<b>128,012</b>	\$	56,698

Comprehensive income is the aggregate of net income and other comprehensive income (OCI). Comprehensive income for the year was \$128.0 million compared to \$56.7 million in 2017.

OCI for the year was a loss of \$4.6 million compared to a gain of \$49.2 million in 2017. The other comprehensive loss primarily resulted from decreases in the fair value of the Company's securities and unrealized losses related to cash flow hedges. The 2017 gain in OCI primarily reflects the transfer to the consolidated statements of income of previously recognized losses on the market value of available for sale securities following the liquidation of preferred shares to raise funds in connection with the 2017 liquidity event.

## Financial Position Review

### Assets

**Table 12: Loan Portfolio (Gross of Allowance for Credit Losses)**

(000s, except % and number of loans)	2018	% of Total	2017	% of Total
CMHC-sponsored securitized single-family residential mortgages	\$ 2,441,279	10.6%	\$ 2,291,066	10.2%
CMHC-sponsored securitized multi-unit residential mortgages	310,652	1.4%	558,042	2.5%
Bank-sponsored securitization conduit single-family residential mortgages	48,692	0.2%	144,142	0.6%
Traditional single-family residential mortgages	10,535,512	45.9%	9,633,919	42.8%
Accelerator single-family residential mortgages	533,076	2.3%	403,332	1.8%
Residential commercial mortgages	219,395	1.0%	114,357	0.5%
Non-residential commercial mortgages	1,451,706	6.3%	1,045,603	4.6%
Credit card loans and lines of credit	405,051	1.8%	352,062	1.6%
Other consumer retail loans	319,024	1.4%	361,166	1.6%
Total loan portfolio	16,264,387	70.9%	14,903,689	66.2%
Loans held for sale	130,351	0.6%	165,947	0.7%
Total on-balance sheet loans	\$ 16,394,738	71.5%	\$ 15,069,636	66.9%
Off-balance sheet loans				
Single-family residential mortgages	\$ 2,700,339	11.8%	\$ 3,972,249	17.7%
Multi-unit residential mortgages	3,838,197	16.7%	3,476,790	15.4%
Total off-balance sheet loans	6,538,536	28.5%	7,449,039	33.1%
Total loans under administration	\$ 22,933,274	100.0%	\$ 22,518,675	100.0%
Total insured mortgages under administration	\$ 10,046,097	45.2%	\$ 11,014,393	50.5%
Total uninsured mortgages under administration	12,163,102	54.8%	10,791,054	49.5%
Total mortgages under administration	\$ 22,209,199	100.0%	\$ 21,805,447	100.0%
Number of loans outstanding under administration				
Mortgages	51,970		54,595	
Credit card loans and lines of credit	77,613		41,736	
Other consumer retail loans	107,155		109,179	
Total number of loans outstanding	236,738		205,510	



Total loans under administration were \$22.93 billion at the end of 2018, an increase of \$414.6 million or 1.8% from the end of 2017. The increases in total loans under administration resulted from an increase in the on-balance sheet portfolio, partially offset by a decrease in off-balance sheet loans. On-balance sheet loans were up 8.8% from the end of 2017, while off-balance sheet loans were down 12.2% from the end of 2017. The increase in on-balance sheet loans reflects the Company's origination and retention efforts. The decrease in off-balance sheet loans has resulted from the Company retaining its residual interests in securitized insured single-family residential mortgages. The increase in the number of credit card loans and lines of credit resulted primarily from an increase in unsecured credit cards. As these cards have relatively low authorized limits and balances outstanding, the impact on the total credit card loans and lines of credit balance was not proportionate to the increase in number of cards issued.

**Table 13: Mortgage Continuity**

The following table presents the activity during the year in relation to the Company's on-balance sheet mortgage portfolio. Single-family residential mortgages and residential commercial mortgages include both non-securitized mortgages and securitized mortgages. Residential commercial mortgages include loans held for sale.

(000s)	2018			
	Single-family Residential Mortgages	Residential Commercial Mortgages	Non- Residential Commercial Mortgages	Total
Balance at the beginning of the year	\$ 12,472,459	\$ 838,346	\$ 1,045,603	\$ 14,356,408
Originations	3,995,078	679,509	764,806	5,439,393
Renewal of mortgages previously derecognized <sup>1</sup>	610,537	58,856	—	669,393
Scheduled payments and prepayments <sup>2</sup>	(321,064)	(20,047)	(44,632)	(385,743)
Discharges	(3,212,972)	(246,359)	(319,511)	(3,778,842)
Capitalization and amortization of fees and other	14,521	768	5,440	20,729
Sales of mortgages and residual interests	—	(650,675)	—	(650,675)
Balance at the end of the year	\$ 13,558,559	\$ 660,398	\$ 1,451,706	\$ 15,670,663

(000s)	2017			
	Single-family Residential Mortgages	Residential Commercial Mortgages	Non- Residential Commercial Mortgages	Total
Balance at the beginning of the year	\$ 14,330,599	\$ 1,003,299	\$ 1,954,850	\$ 17,288,748
Originations	3,342,591	678,512	699,746	4,720,849
Renewal of mortgages previously derecognized <sup>1</sup>	547,178	19,199	—	566,377
Scheduled payments and prepayments <sup>2</sup>	(336,610)	(20,826)	(60,783)	(418,219)
Discharges	(4,849,952)	(162,776)	(541,606)	(5,554,334)
Capitalization and amortization of fees and other	44,390	(1,277)	1,478	44,591
Sales of mortgages and residual interests	(605,737)	(677,785)	(1,008,082)	(2,291,604)
Balance at the end of the year	\$ 12,472,459	\$ 838,346	\$ 1,045,603	\$ 14,356,408

<sup>1</sup> Represents renewals of mortgages that were previously derecognized and included in the off-balance sheet portfolio. Upon renewal, the mortgages are recognized on the balance sheet.

<sup>2</sup> Includes regularly scheduled principal payments and unscheduled partial payments.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

**Table 14: Mortgage Originations by Type and Province**

(000s, except %)	2018	% of Total	2017	% of Total
Single-family residential mortgages				
Traditional	\$ 3,757,685	69.1%	\$ 3,060,818	64.8%
Accelerator	237,393	4.3%	281,773	6.0%
Residential commercial mortgages				
Multi-unit uninsured residential mortgages	131,468	2.4%	71,854	1.5%
Multi-unit insured residential mortgages	516,133	9.5%	599,843	12.7%
Other <sup>1</sup>	31,908	0.6%	6,815	0.1%
Non-residential commercial mortgages				
Stores and apartments	68,696	1.3%	45,499	1.0%
Commercial	696,110	12.8%	654,247	13.9%
<b>Total mortgage originations</b>	<b>\$ 5,439,393</b>	<b>100.0%</b>	<b>\$ 4,720,849</b>	<b>100.0%</b>

(000s, except %)	2018	% of Total	2017	% of Total
British Columbia	\$ 698,714	12.8%	\$ 326,081	6.9%
Alberta	144,365	2.7%	71,070	1.5%
Ontario	4,066,454	74.8%	4,057,887	85.9%
Quebec	293,410	5.4%	167,631	3.6%
Other	236,450	4.3%	98,180	2.1%
<b>Total mortgage originations</b>	<b>\$ 5,439,393</b>	<b>100.0%</b>	<b>\$ 4,720,849</b>	<b>100.0%</b>

<sup>1</sup> Other residential commercial mortgages include mortgages such as builders' inventory.

### Mortgage Lending

#### Uninsured Residential Mortgages – Traditional Mortgages

The Company's uninsured residential mortgage portfolio is represented by its traditional mortgage portfolio, which includes its ACE Plus product. Traditional single-family residential mortgages of \$10.54 billion represent the largest portfolio within loans under administration and on-balance sheet loans at 45.9% and 64.3%, respectively. Mortgage originations of \$3.76 billion in 2018 were up \$696.9 million or 22.8% from 2017. The Company continues its efforts to improve its mortgage originations following the decline in originations that occurred in 2017 as a result of the liquidity event.

#### Insured Residential Mortgages

Insured residential loans under administration, which include both insured single-family and multi-unit residential mortgages, were \$10.05 billion at the end of 2018, a decrease of 8.8% from the balance of \$11.01 billion at the end of 2017. Of this total, \$6.54 billion were accounted for off-balance sheet, down \$910.5 million or 12.2% from 2017.

The Company originated \$237.4 million in insured single-family Accelerator mortgages in 2018, down \$44.4 million or 15.8% from 2017. The Company views its Accelerator product offering as complementary to its traditional portfolio.

In 2018, the Company originated \$516.1 million of insured multi-unit residential mortgages and sold \$650.7 million that qualified for off-balance sheet treatment, resulting in \$4.6 million in gains on sale. The multi-unit residential mortgage market is relatively limited and the Company participates in appropriate transactions as they become available through various origination channels. As a result, origination volumes, sales and resultant securitization gains can vary significantly through the year. All of the Company's new insured multi-unit residential originations qualify for off-balance sheet treatment, and the on-balance sheet securitized multi-unit residential portfolio is declining through amortization and maturities.

From time to time, the Company pools mortgages and may hold the related MBS as liquid assets or inventory for replacement assets for the CMB program. As these MBS are not sold, they are carried on the balance sheet at amortized cost as part of residential mortgage loans (see Table 35: Liquidity Resources).

#### Residential Commercial Mortgages

Residential commercial mortgages include commercial mortgages that are secured by residential property such as non-securitized multi-unit residential mortgages and builders' inventory. Insured multi-unit residential mortgages are included in this portfolio until they are securitized.

## Non-residential Commercial Mortgages

Non-residential commercial originations were \$764.8 million in 2018 compared to \$699.7 million in 2017. Non-residential commercial mortgages, which include loans on office, industrial, retail and mixed-use properties as well as commercial mortgages on development projects, have been an important complementary source of loan assets and revenue. The Company expects to continue conservatively participating in appropriate commercial mortgage opportunities as they arise.

## Geographic Concentration

Mortgage originations continued to favour Ontario and, in particular, the GTA, during the year. The Company will continue to cautiously increase business within other markets in Ontario and the rest of Canada to the extent that market conditions remain stable. The concentration of new originations is influenced, in part, by the Company's credit experience. Please see Note 5(B) to the consolidated financial statements included in this report for the geographic distribution of the portfolio.

**Table 15: Consumer Lending Continuity**

(000s)	2018			2017		
	Credit Card Loans and Lines of Credit	Other Consumer Retail Loans	Total Consumer Lending	Credit Card Loans and Lines of Credit	Other Consumer Retail Loans	Total Consumer Lending
Balance at the beginning of the year	\$ 352,062	\$ 361,166	\$ 713,228	\$ 370,458	\$ 379,312	\$ 749,770
Advances and draw-downs	334,771	115,733	450,504	218,377	197,962	416,339
Repayments	(323,856)	(210,863)	(534,719)	(274,744)	(270,424)	(545,168)
Capitalization of interest and fees, portfolio sales and other	42,074	52,988	95,062	37,971	54,316	92,287
Balance at the end of the year	\$ 405,051	\$ 319,024	\$ 724,075	\$ 352,062	\$ 361,166	\$ 713,228
Authorized limit on new credit card and line of credit issuances	\$ 362,510			\$ 128,897		

## Consumer Lending

Consumer lending, comprising credit cards, lines of credit and other consumer retail loans, continues to be an important source of loan assets with attractive returns. While representing 4.4% of total gross on-balance sheet loans, these assets generated 8.6% of the interest income from loans for the year.

Gross credit card and lines of credit balances increased to \$405.1 million at the end of 2018 from \$352.1 million at the end of 2017. Equityline Visa (HELOC) accounts represent 87.6% of the total credit card and lines of credit balance.

The balance of other consumer retail loans decreased to \$319.0 million at the end of 2018 from \$361.2 million at the end of 2017. The decrease resulted from the early payout of \$38.4 million on certain portfolios of consumer retail loans. The Company expects additional early payouts in the future. These assets are typically generated through dealer programs which continue to be in place. The Company ceased the origination of HVAC rental loans in 2018.

## Cash Resources and Securities

Combined cash resources and securities of \$1.05 billion at the end of 2018 decreased by \$616.3 million from \$1.67 billion at the end of 2017, reflecting a decrease in cash resources, resulting primarily from the maturity of institutional deposit notes of \$475 million and the repurchase of \$300 million of shares under the Company's SIB. The Company maintains sufficient liquidity to meet its future commitments and expected business volumes.

The Company has a \$500 million committed secured standby credit facility with a syndicate of Canadian chartered banks, which is undrawn.

The Company has a \$300 million secured warehouse credit facility with a syndicate of Canadian chartered banks. The balance at December 31, 2018 included in credit facilities on the consolidated balance sheets was \$261.5 million.

The Company also has an uncommitted secured credit facility with a Canadian chartered bank in the amount of \$20 million, which is undrawn.

The details of the above facilities are disclosed in Note 4(A) to the consolidated financial statements included in this report.

In addition to holding cash and securities, the Company maintains prudent liquidity by investing a portion of the liquid assets in Company-originated MBS. Although these securities are available for liquidity purposes, they are classified as residential mortgages on the balance sheet, as required by GAAP.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The securities portfolio consists of bonds and preferred shares. Government bonds represented 93.2% of the securities portfolio (2017 – 90.4%). The entire bond portfolio of \$360.0 million (2017 – \$300.6 million) is investment grade. At December 31, 2018, the preferred share portfolio was \$26.4 million or 6.8% of the Company's securities compared to \$30.9 million or 9.3% at the end of 2017. Investment-grade preferred shares represented 97.0% of the preferred share portfolio (2017 – 96.9%). The Company had no residual interests of underlying securitized insured fixed-rate residential mortgages at December 31, 2018 (2017 – 0.3% of the securities portfolio).

Additional details related to the Company's securities portfolio can be found in Note 4 to the consolidated financial statements included in this report.

**Table 16: Other Assets**

(000s)	2018		2017	
Restricted assets				
Restricted cash	\$	262,215	\$	254,134
Acceptable securities assigned as replacement assets		46,990		182,877
Derivative assets		8,925		7,325
Other assets				
Accrued interest receivable		55,469		49,651
Prepaid CMB coupon		2,895		3,644
Securitization receivable and retained interest		162,256		182,930
Capital assets		8,665		10,431
Income taxes recoverable		37,282		13,340
Other prepaid assets and deferred items		72,420		76,774
Deferred tax assets		3,489		9,577
Goodwill and intangible assets				
Goodwill		2,324		2,324
Intangible assets		83,432		98,669
	\$	746,362	\$	891,676

Total other assets decreased by \$145.3 million from the end of 2017 primarily as a result of a decrease of \$135.9 million in acceptable securities assigned as replacement assets in the CMB program, reflecting the Company's increased use of securitized mortgage pools relative to securities as replacement assets. In general, as CMB maturities approach, the Company has historically replaced maturing securitized mortgages with other acceptable securities. Further information on the Company's securitization activity can be found in Note 6 to the consolidated financial statements included in this report.

## Liabilities

### Deposits and Securitization Liabilities

**Table 17: Deposits and Securitization Liabilities**

(000s, except % and number of accounts)	2018	% of Totals	2017	% of Totals
Deposits payable on demand				
High-interest savings accounts	\$ 147,183	1.2%	\$ 138,948	1.1%
Oaken savings accounts	194,218	1.5%	229,511	1.9%
Other deposits payable on demand	95,645	0.7%	170,905	1.4%
	437,046	3.4%	539,364	4.4%
Deposits payable on fixed dates				
Brokered GICs <sup>1</sup>	10,053,280	77.4%	9,350,235	76.9%
Oaken GICs <sup>1</sup>	2,486,764	19.2%	1,805,332	14.8%
Institutional deposit notes	—	—	475,523	3.9%
	12,540,044	96.6%	11,631,090	95.6%
Total deposits	12,977,090	100.0%	12,170,454	100.0%
Securitization liabilities				
CMHC-sponsored mortgage-backed security liabilities	1,573,216	55.0%	1,562,152	49.1%
CMHC-sponsored Canada Mortgage Bond liabilities	1,239,331	43.4%	1,473,318	46.4%
Bank-sponsored securitization conduit liabilities	46,779	1.6%	142,279	4.5%
Total securitization liabilities	\$ 2,859,326	100.0%	\$ 3,177,749	100.0%
Total number of deposit accounts	439,761		391,182	

<sup>1</sup> Included in Brokered and Oaken GICs presented above as payable on fixed dates are \$148.8 million of cashable GICs that have reached the required number of days to be payable on demand. In the absence of such demand, the GICs have a remaining contractual term to maturity of within one year.

**Table 18: Non-Securitized Loans and Deposits by Remaining Contractual Term to Maturity**

(000s)

December 31, 2018

	Payable on Demand	0–3 Months	3–12 Months	1 to 3 Years	Over 3 Years	Total
<b>Non-securitized loans</b>						
Single-family residential mortgages	\$ —	\$ 1,985,929	\$ 6,357,844	\$ 2,381,298	\$ 343,517	\$ 11,068,588
Residential commercial mortgages	—	36,625	33,920	143,434	5,416	219,395
Non-residential commercial mortgages	—	269,268	429,636	724,765	28,037	1,451,706
Credit card loans and lines of credit	—	405,051	—	—	—	405,051
Other consumer retail loans	—	5,722	25,814	75,914	211,574	319,024
	—	2,702,595	6,847,214	3,325,411	588,544	13,463,764
<b>Deposits<sup>1</sup></b>	<b>437,046</b>	<b>1,491,049</b>	<b>4,378,240</b>	<b>4,667,035</b>	<b>2,003,720</b>	<b>12,977,090</b>
<b>Net maturity</b>	<b>\$ (437,046)</b>	<b>\$ 1,211,546</b>	<b>\$ 2,468,974</b>	<b>\$ (1,341,624)</b>	<b>\$ (1,415,176)</b>	<b>\$ 486,674</b>

<sup>1</sup> Included in deposits presented above as payable within one year are \$148.8 million of cashable GICs that have reached the required number of days to be payable on demand. In the absence of such demand, the GICs have a remaining contractual term to maturity of within one year.

The Company's deposit portfolio primarily provides funding for the non-securitized loan portfolio and principally comprises fixed-term deposits, which represent 96.6% of all deposits, thereby reducing the risk of untimely withdrawal of funds by retail clients. The Company generally matches the terms of its deposits with its assets. The above table presents the net remaining contractual term to maturity of the Company's non-securitized loans and deposits. Please see the Structural Interest Rate Risk and the Liquidity and Funding Risk sections of this MD&A for more information.

The Company continued to source deposits primarily through deposit brokers and investment dealers. Other deposits payable on demand include amounts collected for real estate tax accounts, which are generally paid out in accordance with each municipality's payment frequency requirements. Please see Note 11 to the consolidated financial statements included in this report for a breakdown of the Company's deposit portfolio by remaining contractual term to maturity and yield.

Total deposits of \$12.98 billion increased 6.6% from the end of 2017. Deposits raised through the Company's direct-to-consumer brand, Oaken Financial represented 20.7% of total deposits at the end of 2018 compared to 16.7% at the end of 2017. The balance of Oaken deposits at the end of 2018 was \$2.68 billion, reflecting an increase of 31.8% over the balance at the end of 2017. In addition, the Company repaid all of its \$475 million of institutional deposit notes in 2018 on their maturity dates.

Securitization liabilities, including both CMHC- and bank-sponsored liabilities, decreased \$318.4 million from the end of 2017 due to the maturity of CMB liabilities as well as a decrease in bank-sponsored securitization conduit liabilities. CMB liabilities are bullet bonds and only decline when the underlying bonds mature.

**Table 19: Other Liabilities**

(000s)

2018

2017

Credit facilities	\$ 261,506	\$ —
Derivative liabilities	35,975	38,728
Other liabilities		
Accrued interest payable on deposits	155,112	125,965
Accrued interest payable on securitization liabilities	7,808	7,923
Securitization servicing liability	21,178	20,924
Other, including accounts payable and accrued liabilities	154,246	205,665
Deferred tax liabilities	28,838	30,230
	<b>\$ 664,663</b>	<b>\$ 429,435</b>

Total other liabilities increased \$235.2 million from the end of 2017. The increase in other liabilities resulted primarily from amounts drawn on the new secured warehouse credit facility. Accrued interest payable on deposits also increased, reflecting the growth in deposits and increase in deposit rates. The increase in other liabilities was partially offset by a decrease in accounts payable and accrued liabilities, which fluctuates based on timing of the payment of associated liabilities.

## Shareholders' Equity

Table 20: Shareholders' Equity

(000s)	2018	2017
Shareholders' equity at the beginning of the year	\$ 1,813,505	\$ 1,632,587
Net income	132,603	7,527
Other comprehensive (loss) income	(4,591)	49,171
Amounts related to stock-based compensation	(395)	964
Repurchase of shares	(300,512)	(5,999)
Issuance of shares	—	145,965
Dividends	—	(16,710)
Shareholders' equity at the end of the year	\$ 1,640,610	\$ 1,813,505

The decrease of \$172.9 million in total shareholders' equity since December 31, 2017 resulted primarily from the repurchase of \$300 million of shares under the Company's SIB along with \$0.5 million (net of tax) of transaction costs associated with the SIB. The decrease was partially offset by internally generated net income of \$132.6 million. Please see Notes 13 and 14 to the consolidated financial statements included in this report for more information.

At December 31, 2018, the book value per common share was \$26.43, compared to \$22.60 at December 31, 2017. The increase in book value per common share from the end of 2017 resulted from the repurchase of shares following the completion of the SIB as well as from net income.

## Contingencies and Contractual Obligations

In the normal course of its activities, the Company enters into various types of contractual agreements. The Company ensures that sufficient cash resources are available to meet these contractual obligations when they become due.

The following table presents a summary of the Company's contractual obligations comprising minimum lease payments on premises, property, computer hardware and software as at December 31, 2018.

Table 21: Contractual Obligations

(000s)	2019	2020	2021	2022	2023	Thereafter	Total
Minimum lease payments	\$ 11,698	\$ 9,336	\$ 8,838	\$ 7,487	\$ 6,652	\$ 18,261	\$ 62,272

The Company also has outstanding commitments for future advances on mortgages and unutilized and available credit on its credit card and lines of credit products. Refer to the Off-balance Sheet Arrangements section of this MD&A and Note 17 to the consolidated financial statements included in this report for a description of those commitments.

## Off-balance Sheet Arrangements

The Company offers credit products to meet the financial needs of its customers and has outstanding amounts for future advances on mortgages, which were \$1.00 billion at December 31, 2018 (\$875.9 million – December 31, 2017). These amounts include offers made but not yet accepted by the customer as of the reporting date. Also included within the outstanding amounts were unutilized non-residential commercial loan advances of \$386.7 million at December 31, 2018 (\$196.7 million – December 31, 2017). Offers for the loans remain open for various periods. As at December 31, 2018, unutilized credit card balances amounted to \$355.8 million (\$145.5 million – December 31, 2017). Included in the outstanding amounts for future advances of mortgage loans are outstanding future advances for the Equityline Visa portfolio of \$28.6 million at December 31, 2018 (\$16.1 million – December 31, 2017). The unutilized credit and offers to extend credit are in the normal course of business and are considered through the Company's liquidity and capital management processes.

The Company has \$6.54 billion (2017 – \$7.45 billion) of loans under administration that are accounted for off-balance sheet (see Table 12). Please refer to Note 2 and Note 6 of the consolidated financial statements included in this report for details of the Company's securitization activities.

## Related Party Transactions

IFRS considers key management personnel to be related parties. Compensation of key management personnel is disclosed in Note 21 of the consolidated financial statements included in this report.

# Quarterly Financial Highlights

**Table 22: Summary of Quarterly Results<sup>1</sup>**

	2018								2017	
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1		
Net interest income (loss) (TEB <sup>2</sup> )	\$ 90,449	\$ 89,962	\$ 84,240	\$ 88,204	\$ 91,818	\$ 88,853	\$ (3,298)	\$ 126,682		
Less: TEB adjustment	125	115	111	104	100	91	109	825		
Net interest income (loss) per financial statements	90,324	89,847	84,129	88,100	91,718	88,762	(3,407)	125,857		
Non-interest income (loss)	18,052	15,239	17,496	15,665	17,737	6,645	(57,886)	21,885		
Non-interest expense	55,658	55,602	55,426	51,387	65,490	59,924	85,001	64,465		
Total revenue	108,376	105,086	101,625	103,765	109,455	95,407	(61,293)	147,742		
Net income (loss)	35,811	32,600	29,606	34,586	30,619	29,983	(111,116)	58,041		
Return on shareholders' equity	8.1%	6.9%	6.4%	7.6%	6.8%	6.8%	(25.9)%	14.0%		
Return on average total assets	0.8%	0.7%	0.7%	0.8%	0.7%	0.6%	(2.2)%	1.1%		
Total assets under administration	24,680,225	24,657,402	25,001,732	24,776,803	25,040,182	26,659,330	28,292,436	29,583,545		
Total loans under administration	22,933,274	22,818,087	22,513,861	22,541,079	22,518,675	23,238,410	25,868,248	27,169,129		
Earnings (loss) per common share										
Basic	\$ 0.46	\$ 0.41	\$ 0.37	\$ 0.43	\$ 0.38	\$ 0.37	\$ (1.73)	\$ 0.90		
Diluted	\$ 0.46	\$ 0.41	\$ 0.37	\$ 0.43	\$ 0.38	\$ 0.37	\$ (1.73)	\$ 0.90		
Book value per common share	\$ 26.43	\$ 23.82	\$ 23.40	\$ 23.04	\$ 22.60	\$ 22.20	\$ 21.82	\$ 26.18		
Efficiency ratio (TEB <sup>2</sup> )	51.3%	52.9%	54.5%	49.5%	59.8%	62.7%	(138.9)%	43.4%		
Common equity tier 1 ratio <sup>3</sup>	18.94%	23.27%	23.21%	23.64%	23.17%	21.25%	17.06%	16.34%		
Tier 1 capital ratio <sup>3</sup>	18.93%	23.27%	23.21%	23.64%	23.17%	21.25%	17.06%	16.34%		
Total capital ratio <sup>3</sup>	19.38%	23.74%	23.67%	24.12%	23.68%	21.74%	17.54%	16.77%		
Net non-performing loans as a % of gross loans	0.47%	0.34%	0.34%	0.29%	0.30%	0.28%	0.23%	0.24%		
Annualized provision as a % of gross uninsured loans	0.12%	0.13%	0.22%	0.20%	0.12%	(0.14)%	0.07%	0.16%		
Annualized provision as a % of gross loans	0.10%	0.10%	0.17%	0.16%	0.09%	(0.11)%	0.05%	0.13%		

<sup>1</sup> The amounts pertaining to 2018 have been prepared in accordance with IFRS 9; prior period amounts have not been restated and have been prepared in accordance with IAS 39. Please see Note 2 to the audited consolidated financial statements included in this report for further information.

<sup>2</sup> See definition of Taxable Equivalent Basis (TEB) under Non-GAAP Measures in this report.

<sup>3</sup> These figures relate to the Company's operating subsidiary, Home Trust Company.

The Company's key financial measures for each of the last eight quarters are summarized in the table above. These highlights illustrate the Company's profitability, return on equity, efficiency measures and capital ratios. Most of the above financial measures subsequent to Q1 2017 were significantly impacted by the liquidity event experienced in Q2 2017. The quarterly results are modestly affected by seasonal factors, with first quarter mortgage originations typically impacted by winter weather conditions, while the second and third quarters have traditionally experienced higher levels of originations. First-quarter credit statistics may experience a decline reflecting post-holiday arrears increases.



## Fourth Quarter 2018

Table 23: Fourth Quarter Financial Results

	For the three months ended		
(000s, except % and per share amounts)	December 31 2018	September 30 2018	December 31 2017
<b>INCOME STATEMENT SUMMARY</b>			
Net interest income non-securitized assets <sup>1</sup>	\$ 86,066	\$ 85,944	\$ 89,088
Net interest income securitized loans and assets <sup>1</sup>	4,258	3,903	2,630
Total net interest income <sup>1</sup>	90,324	89,847	91,718
Provision for credit losses <sup>1</sup>	3,932	3,990	3,434
	86,392	85,857	88,284
Non-interest income	18,052	15,239	17,737
Non-interest expenses	55,658	55,602	65,490
Income before income taxes	48,786	45,494	40,531
Income taxes	12,975	12,894	9,912
Net income	35,811	32,600	30,619
Basic earnings per share	\$ 0.46	\$ 0.41	\$ 0.38
Diluted earnings per share	\$ 0.46	\$ 0.41	\$ 0.38
<b>FINANCIAL MEASURES</b>			
Return on shareholders' equity (annualized)	8.1%	6.9%	6.8%
Return on average assets (annualized)	0.8%	0.7%	0.7%
Total net interest margin (TEB)	1.99%	2.03%	2.02%
Net interest margin non-securitized interest-earning assets (TEB)	2.33%	2.42%	2.46%
Net interest margin CMHC-sponsored securitized assets	0.54%	0.48%	0.30%
Provision as a percentage of gross uninsured loans (annualized)	0.12%	0.13%	0.12%
Provision as a percentage of gross loans (annualized)	0.10%	0.10%	0.09%
Efficiency ratio (TEB)	51.3%	52.9%	59.8%
<b>MORTGAGE ORIGINATIONS</b>			
Single-family residential mortgages	\$ 1,160,051	\$ 1,015,998	\$ 566,047
Residential commercial mortgages	237,609	207,596	194,792
Non-residential commercial mortgages	216,504	212,199	111,213
Total mortgage originations	\$ 1,614,164	\$ 1,435,793	\$ 872,052

<sup>1</sup> The amounts pertaining to 2018 have been prepared in accordance with IFRS 9; prior period amounts have not been restated and have been prepared in accordance with IAS 39. Please see Note 2 to the audited consolidated financial statements included in this report for further information.

### Income Statement Summary

- > Net income of \$35.8 million in Q4 2018 was 17.0% higher than the \$30.6 million net income recorded in Q4 2017 and 9.8% higher compared to \$32.6 million in Q3 2018.
- > Diluted earnings per share for the fourth quarter were \$0.46, compared to \$0.38 in Q4 2017 and \$0.41 in Q3 2018. The increase in earnings per share resulted primarily from the increase in net income. The reduction in average number of common shares outstanding following the repurchase of shares under the Company's SIB in December 2018 also contributed to the increase in earnings per share.
- > Return on shareholders' equity was 8.1% in Q4 2018, compared to 6.8% in Q4 2017 and 6.9% in Q3 2018. The improvement in return on equity resulted from the increase in net income combined with the reduction in shareholders' equity following the completion of the SIB.
- > Total net interest income of \$90.3 million for the quarter declined by 1.5% from Q4 2017, reflecting the decrease in total net interest margin (TEB) to 1.99% from 2.02% last year. Total net interest income for the quarter increased by 0.5% from Q3 2018, while the net interest margin (TEB) decreased from 2.03% last quarter. The decreases in total net interest margin from both last year and last quarter resulted from decreases in net interest margin on the non-securitized portfolio offset partially by increases in net interest margins on the securitized portfolios.

- > Net interest margin non-securitized interest-earning assets (TEB) decreased to 2.33% in Q4 2018 from 2.46% in Q4 2017 and 2.42% in Q3 2018. The decrease in non-securitized net interest margin from both last year and last quarter reflects the impact of increased funding costs resulting from increases in market rates without a commensurate increase in mortgage rates. In addition, in order to raise liquidity to fund the repurchase of common shares under its SIB and to repay the remaining institutional deposit notes, the Company increased inflows of GIC deposits in Q4 2018 by offering more attractive deposit rates. Both this increase in rates and volume of GIC deposits contributed to the increased funding costs in Q4 2018. While the Company earned prepayment income on the early payout of certain portfolios of consumer retail loans in both Q4 2018 and Q4 2017, the amount of such prepayment income earned in 2018 was significantly less than that earned in 2017. This decrease in prepayment penalty income contributed to the decline in net interest margin from last year. As there was no such prepayment income in Q3 2018, the prepayment income earned in Q4 2018 helped to partially offset the decline in net interest margin from last quarter. During the year, the Company replaced its previous \$2 billion standby credit facility with a new \$500 million facility, significantly reducing standby fees, and partially offsetting the decline in net interest margin from 2017.
- > Total income earned from securitization includes both net interest income on securitized assets and securitization income arising from sales of securitized assets. Combined net interest income on securitized assets and securitization income was \$6.9 million in Q4 2018, up from \$4.3 million in Q4 2017 and consistent with the \$7.0 million in Q3 2018. The increase over last year resulted from improved securitized net interest margins and an increase in the securitization and sale of insured multi-unit residential mortgages.
- > Fees and other income of \$12.5 million in Q4 2018 were down from \$16.3 million in Q4 2017 and up from \$11.8 million in Q3 2018. The decrease in fees and other income from Q4 2017 reflects the sale of the Company's PSiGate and prepaid card business in Q1 2018.
- > The credit quality of the loan portfolio remained strong in the quarter with the level of credit losses and non-performing loans remaining low. Provision for credit losses for the quarter was \$3.9 million, compared to \$3.4 million in Q4 2017 and \$4.0 million in Q3 2018. The annualized credit provision as a percentage of gross uninsured loans for the quarter was 0.12%, unchanged from Q4 2017 and down slightly from 0.13% in Q3 2018. Net non-performing loans as a percentage of gross loans ended 2018 at 0.47%, compared to 0.30% at the end of 2017 and 0.34% at the end of Q3 2018. Provision for credit losses was calculated under IFRS 9 for 2018 and under IAS 39 for 2017. As provision for credit losses was not restated for 2017, comparability is reduced to some extent.
- > Non-interest expenses were \$55.7 million in Q4 2018, down from \$65.5 million in Q4 2017 and consistent with \$55.6 million in Q3 2018. The decrease in non-interest expenses from last year resulted from a decrease in other operating expenses. Other operating expenses for Q4 2017 included impairment losses on intangible assets along with costs related to the exit of the PSiGate and prepaid card business and litigation-related costs. The decrease in other operating expenses was partially offset by an increase in salaries and benefits reflecting an increase in the average number of employees.

## Financial Position Summary

- > Total loans under administration, which includes securitized mortgages that qualify for off-balance sheet accounting, increased by \$115.2 million or 0.5% from \$22.82 billion at the end of Q3 2018, reflecting an increase in total on-balance sheet loans. Total loans were \$16.39 billion at the end of 2018, an increase of \$352.0 million or 2.2% from \$16.04 billion at the end of Q3 2018, reflecting the Company's originations and retention efforts. The increase in on-balance sheet loans was offset partially by a decrease in off-balance sheet mortgages resulting from the Company retaining its interests in securitized single-family residential mortgages.
- > The total value of mortgages originated in Q4 2018 was \$1.61 billion, compared to \$872.1 million in Q4 2017 and \$1.44 billion in Q3 2018.
- > The Company originated \$1.11 billion of traditional single-family residential mortgages in Q4 2018, compared to \$537.4 million in Q4 2017 and \$959.1 million in Q3 2018.
- > Accelerator (insured) single-family residential mortgage originations were \$48.0 million in Q4 2018, compared to \$28.6 million in Q4 2017 and \$56.9 million in Q3 2018.
- > Residential commercial originations were \$237.6 million in the quarter, compared to \$194.8 million in Q4 2017 and \$207.6 million in Q3 2018. Multi-unit residential mortgage originations are mostly insured and subsequently securitized through programs that qualify for off-balance sheet accounting.
- > Non-residential commercial mortgage originations, which include store and apartment mortgages, were \$216.5 million in Q4 2018, compared to \$111.2 million in Q4 2017 and \$212.2 million in Q3 2018.
- > Liquid assets were \$1.29 billion, compared to \$1.38 billion at the end of Q3 2018. The Company maintains a prudent level of liquidity, given the current level of operations and the Company's obligations.
- > Deposits were \$12.98 billion, up from \$12.36 billion at the end of Q3 2018. Deposits raised through the Company's direct-to-consumer brand, Oaken Financial represented 20.7% of total deposits at the end of 2018 consistent with the end of Q3 2018.
- > Home Trust's Common Equity Tier 1 (CET 1) and Total capital ratios remained strong at 18.94% and 19.38%, respectively, at December 31, 2018, compared to 23.27% and 23.74%, respectively, at September 30, 2018. The decrease in capital ratios resulted from a combination of reduced capital and an increase in risk-weighted assets. The reduction in Home Trust regulatory capital resulted from the declaration of dividends from Home Trust to the Company in support of the SIB. The increase in risk-weighted assets reflects growth in the mortgage portfolio. The capital ratios remain well above Company and regulatory minimum targets. Home Trust's Leverage ratio was 7.54% at December 31, 2018, also well above regulatory minimums.

## Capital Management

Capital is a key factor in the safety and soundness of a financial institution. A strong capital position assists the Company in promoting confidence among depositors, creditors, regulators and shareholders. The Company's capital management policy governs the quantity and quality of capital held. The objective of the capital management policy is to ensure that adequate capital is available to the Company to support its strategic and business objectives, absorb potential unexpected losses, meet minimum regulatory capital requirements as stipulated by the Office of the Superintendent of Financial Institutions Canada (OSFI), and enable the allocation of capital for maximum economic benefit. The Capital Management Committee reviews compliance with the policy at minimum on a monthly basis, while the Risk and Capital Committee and the Board review compliance with the policy on a quarterly basis.

Capital requirements are addressed in the Company's policy, including the Leverage ratio and the risk-based capital ratios. The Capital Management Committee reviews these ratios on a regular basis, while the Board reviews them quarterly.

The Company's principal consolidated subsidiary, Home Trust, which includes its subsidiary Home Bank, calculates capital ratios and regulatory capital based on the capital adequacy requirements issued by OSFI, which are based on *International Convergence of Capital Measurement and Capital Standards – A Revised Framework* (Basel II) and *Basel III: A global regulatory framework for more resilient banks and banking systems – A Revised Framework* (Basel III). As Home Trust is regulated under the *Trust and Loan Companies Act* (Canada) (TLCA) and Home Bank is regulated under the *Bank Act* (Canada), Home Trust's ability to accept deposits is limited primarily by its permitted Leverage ratio (see Table 24). In addition, the declaration and payment of dividends by Home Trust to Home Capital are subject to restrictions under the TLCA.

Under Basel II and Basel III, Home Trust calculates risk-weighted assets for credit risk using the Standardized Approach and for operational risk using the Basic Indicator Approach. Home Trust's capital structure and risk-weighted assets were as follows:

**Table 24: Basel III Regulatory Capital (Based only on Home Trust Company consolidated financial position)**

(000s, except ratios)	December 31 2018	December 31 2017
Common Equity Tier 1 capital (CET 1)		
Capital stock	\$ 38,497	\$ 38,497
Contributed surplus	951	951
Retained earnings	1,437,629	1,604,357
Accumulated other comprehensive loss	(10,485)	(5,897)
Cash flow hedge reserves	1,606	1,189
Regulatory deductions from CET 1 <sup>1</sup>	(96,295)	(125,768)
Total CET 1 capital	1,371,903	1,513,329
Additional Tier 1 capital	—	—
Total Tier 1 capital	1,371,903	1,513,329
Tier 2 capital		
Allowance for credit losses <sup>2</sup>	32,671	33,563
Total Tier 2 capital	32,671	33,563
Total regulatory capital	1,404,574	1,546,892
Risk-weighted assets for		
Credit risk	6,397,266	5,580,361
Operational risk	840,763	942,038
Total risk-weighted assets, before CVA <sup>3</sup>	7,238,029	6,522,399
CVA adjustment for CET 1 capital	7,280	8,650
Total CET 1 capital risk-weighted assets	7,245,309	6,531,049
CVA adjustment for Tier 1 capital	7,553	9,251
Total Tier 1 capital risk-weighted assets	7,245,582	6,531,650
CVA adjustment for total capital	7,826	9,731
Total risk-weighted assets	\$ 7,245,855	\$ 6,532,130
Regulated capital to risk-weighted assets		
CET 1 ratio	18.94%	23.17%
Tier 1 capital ratio	18.93%	23.17%
Total regulatory capital ratio	19.38%	23.68%
Leverage ratio	7.54%	8.70%
National regulatory minimum		
CET 1 ratio	7.00%	7.00%
Tier 1 capital ratio	8.50%	8.50%
Total regulatory capital ratio	10.50%	10.50%
Leverage ratio	3.00%	3.00%

<sup>1</sup> Regulatory deductions include intangible assets, net of deferred taxes, unrealized mortgage securitization gains, net of deferred taxes and deferred tax assets related to loss carryforwards from Home Bank.

<sup>2</sup> The Company is allowed to include eligible allowances for credit losses up to a prescribed percentage of 1.25% of total credit risk-weighted assets, inclusive of total CVA before transitional phase-in adjustments, in Tier 2 capital. At December 31, 2018, the Company's eligible allowances represented 0.51% of total credit risk-weighted assets, inclusive of total CVA.

<sup>3</sup> CVA – Credit Valuation Adjustment.

Home Trust's Total regulatory capital ratios have decreased from the end of 2017, resulting from a combination of changes in regulatory capital and risk-weighted assets. Regulatory capital decreased as a result of Home Trust dividends that were declared in support of Home Capital's repurchase of 18,181,818 common shares under the SIB which reduced capital by \$300 million. The increase in risk-weighted assets resulted primarily from growth in both the residential and commercial mortgage portfolios.

The Leverage ratio is a non-risk-adjusted view of a company's leverage. The Leverage ratio is defined as the Capital Measure divided by the Exposure Measure, with the ratio expressed as a percentage. The Capital Measure is the Tier 1 capital of Home Trust. The Exposure Measure consists of on-balance sheet exposures, potential future exposure amounts on derivatives, credit equivalent amounts of certain off-balance sheet commitments and securities financing transactions. The Company's Leverage ratio is in excess of OSFI's established minimum target of 3%, as well as the minimum ratio assigned to the Company by OSFI and the Company's internal targets. The Company has disclosed the Leverage ratio and its components under "Regulatory Disclosures" on the Home Trust website.

Home Trust's Common Equity Tier 1, Total Tier 1 and Total capital ratios continue to exceed regulatory and internal capital targets.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Home Trust adopted certain Basel III capital requirements beginning January 1, 2013, as required by OSFI. The transitional basis allowed for the transition of certain capital deductions over a period that ended January 1, 2018, whereas the all-in basis includes all applicable deductions immediately. For purposes of meeting minimum regulatory capital ratios prescribed by OSFI, the all-in basis was required. The regulatory capital ratios as at December 31, 2017 and the national regulatory minimum presented in the above table are on an all-in basis.

**Table 25: Risk-Weighted Assets (RWA) (Based only on Home Trust Company consolidated financial position)**

	2018			2017		
(000s, except %)	Balance Sheet Amounts	Effective Risk Weight <sup>1</sup>	Risk-weighted Amount	Balance Sheet Amounts	Effective Risk Weight <sup>1</sup>	Risk-weighted Amount
Cash and cash equivalents	\$ 644,517	20.0%	\$ 128,903	\$ 1,146,147	20.0%	\$ 229,229
Restricted assets	309,205	17.0%	52,443	437,011	11.6%	50,827
Securities	386,333	6.8%	26,353	331,500	9.3%	30,936
Insured residential mortgages	3,507,280	0.4%	15,116	3,565,354	0.5%	18,867
Uninsured single-family residential mortgages	10,495,553	35.3%	3,709,808	9,637,873	35.2%	3,393,375
Uninsured residential commercial mortgages	209,024	100.0%	209,025	105,849	100.0%	105,849
Non-residential commercial mortgages	1,441,896	100.8%	1,453,353	1,042,853	100.7%	1,049,722
Credit card loans and lines of credit	403,370	41.8%	168,459	351,605	42.2%	148,506
Other consumer retail loans	318,595	93.5%	297,911	360,890	75.0%	270,668
Other assets	347,037	74.9%	259,848	341,345	71.4%	243,844
Total assets subject to risk rating	18,062,810	35.0%	6,321,219	17,320,427	32.0%	5,541,823
Deferred tax assets for loss carryforwards	—	—	—	6,390	—	—
Intangible assets	83,432	—	—	98,669	—	—
Allowance for credit losses	(32,671)	—	—	(33,563)	—	—
Total assets	18,113,571	34.9%	6,321,219	17,391,923	31.9%	5,541,823
Off-balance sheet items						
Loan commitments	1,194,097	6.4%	76,047	799,892	4.8%	38,538
Total credit risk	19,307,668		6,397,266	18,191,815		5,580,361
Operational risk	—		840,763	—		942,038
Total risk-weighted assets, before CVA	\$ 19,307,668		\$ 7,238,029	\$ 18,191,815		\$ 6,522,399

<sup>1</sup> The effective risk weight represents the weighted average of the risk weights for each asset category prescribed by OSFI weighted based on the Company's balance sheet classification.

Risk-weighted assets are determined by applying the OSFI-prescribed rules to on-balance sheet and off-balance sheet exposures. The Company's securitization activities are not subject to the Basel II securitization framework as they are all within the NHA MBS program and do not involve tranching of credit risk.

### Capital Management Activity

During the fourth quarter of 2018, the Company repurchased 18,181,818 common shares for \$300 million, under its SIB, thereby reducing retained earnings by \$248.1 million and share capital by \$52.4 million. Included in the amount allocated to retained earnings is \$0.5 million (net of tax) for transaction costs associated with the SIB.

The Company implemented an NCIB on January 2, 2019, which allows it to purchase up to 4,753,517 of its common shares. As at February 21, 2019, the Company has purchased 735,050 common shares under the NCIB. Please refer to the press release issued by the Company on December 24, 2018 for more information. The Company believes that, from time to time, the market price of its common shares does not fully reflect the value of its business and the repurchase of shares may represent an appropriate and desirable business decision.

Home Capital has entered into an automatic purchase plan with a broker in connection with its NCIB. From time to time, when Home Capital does not possess material non-public information about itself or its securities, it may direct its broker to allow for the purchase of common shares at times when Home Capital ordinarily would not be active in the market due to its own internal trading blackout periods, insider trading rules or otherwise. Any such plans entered into with Home Capital's broker will be adopted in accordance with applicable Canadian securities laws.

## Internal Capital Adequacy Assessment Process (ICAAP)

Under the Company's capital and risk management policies, and OSFI's guidelines, the Company is required to assess the adequacy of current and projected capital resources under expected and stressed conditions. This involves evaluating the Company's strategy, financial plan and risk appetite; assessing the effectiveness of its risk and capital management practices (including Board and senior management oversight); subjecting the Company's plans to a range of stress tests; and drawing conclusions about its capital adequacy (including a rigorous review and challenge). Based on the Company's ICAAP, management has concluded that Home Trust is adequately capitalized.

## Credit Ratings

The following table presents the credit ratings for the Company and its subsidiary Home Trust.

**Table 26: Credit Ratings**

	Home Capital Group Inc.		Home Trust Company	
	DBRS	Standard & Poor's	DBRS	Standard & Poor's
Long-term rating	B	BB-	BB (low)	BB+
Short-term rating	R-5	B	R-4	B
Outlook	Stable	Stable	Stable	Stable

## Share Information

**Table 27: Share Information**

(000s)	2018		2017	
	Number of Shares	Amount	Number of Shares	Amount
Common shares issued and outstanding <sup>1</sup>	62,065	\$ 178,782	80,246	\$ 231,156
Employee stock options outstanding <sup>2</sup>	898	N/A	840	N/A
Employee stock options exercisable <sup>2,3</sup>	471	16,730	511	18,333

<sup>1</sup> Please see Note 13(B) of the consolidated financial statements included in this report for details on shares repurchased during 2018 and issued during 2017.

<sup>2</sup> Please see Note 14(C) of the consolidated financial statements included in this report for further information. Amount for employee stock options is not applicable.

<sup>3</sup> For employee stock options exercisable, the amount refers to proceeds payable to the Company upon exercise.

As of February 21, 2019, the total number of common shares issued and outstanding was 61,329,481. The reduction in number of shares outstanding from the end of 2018 resulted from the repurchase of common shares under the NCIB.

## Risk Management

The shaded areas of this section of the MD&A represent a discussion of risk management policies and procedures relating to certain risks that are required under IFRS 7 *Financial Instruments: Disclosures*, which permits these specific disclosures to be included in the MD&A. Therefore, the shaded areas presented in this Risk Management section form an integral part of the audited consolidated financial statements for the year ended December 31, 2018.

### Risk Overview

Risk management is an essential component of the Company's strategy, directly affecting the Company's profitability and return on equity. The Company continues to invest significantly in risk management practices and resources.

The Company's core strategy focuses on serving segments of the Canadian financial services market that traditionally have not been adequately served by larger financial institutions. The Company's strategy provides the opportunity for higher returns but carries an inherently different risk profile than one serving the broader market and requires an integrated risk management strategy. The Company recognizes this risk and proactively seeks to reduce overall risk exposure to an acceptable level through:

- > Identification of the principal risks to the Company's strategy and adoption of policies, guidelines and mitigation strategies to address such risks;
- > Adoption of a risk appetite framework that includes risk capacity, a risk appetite statement, risk limits and other key risk indicators;
- > Adoption of a risk governance structure that includes promotion of a sound risk and compliance culture, a three lines of defence model for the management of risk, and active oversight by the Board and senior management;
- > Extensive risk identification, assessment, measurement and monitoring practices and controls executed by experienced personnel and supported by appropriate processes and technology;

## MANAGEMENT'S DISCUSSION AND ANALYSIS

- > Monitoring of the Company's internal and external environments to identify and respond on a timely basis to emerging risk exposures, and to ensure that risks are considered in all change initiatives; and
- > Robust reporting on risk exposures including establishment of key risk indicators that provide early warning indicators of changes in risk profile.

### Risk Factors That May Affect Future Results

The Company is exposed to a variety of continually changing risks that have the potential to cause the Company's results to differ significantly from the Company's plans, objectives and estimates. All forward-looking statements, including those in this MD&A, are subject to inherent risks and uncertainties, general and specific, which may cause the Company's actual results to differ materially from the expectations expressed in the forward-looking statements. Some of these external factors are discussed below.

#### Top and Emerging Risks

##### *Canadian Housing Market and Canadian Consumer Debt*

The Canadian housing market, and in particular the GTA and Greater Vancouver Area (GVA), remains a top concern for the Company. The Company is closely monitoring the impact of the new federal and provincial measures, designed to cool the housing market, on the Company's mortgage originations. Risks associated with high Canadian household indebtedness remain elevated, particularly considering the rising interest rate environment. The Company expects moderate price appreciation in 2019, reflecting ongoing adjustments of regulatory changes and potentially rising interest rates, which could worsen affordability, especially in the GTA and the Golden Horseshoe area. Stable employment conditions and high levels of immigration are expected to continue to provide support to the Company's primary markets.

The Company continues to apply conservative credit risk management practices, which includes establishing and monitoring prudent risk limits and regular performance of stress tests. The Company believes the risk of a severe housing correction in its established regions to be unlikely, and stress testing results suggest that even a severe real estate decline, coupled with high unemployment rates, would lead to manageable losses.

##### *Regulatory and Political Risk*

The Company is subject to a variety of regulations and related oversight. Regulatory reforms, at the federal and provincial levels of government, aimed at cooling the housing market and strengthening underwriting practices remain a key risk for the Company.

The Company maintains a framework and controls to address compliance with existing laws and regulations and monitors and assesses the potential impact of regulatory developments and implements any necessary changes; however, regulators or other reviewers may challenge the interpretation or implementation of such compliance. Failure to comply with legal and regulatory requirements could result in fines, penalties, litigation, regulatory sanctions and limitations, all of which could have a negative impact on the Company's financial performance, reputation and ability to operate as a regulated entity.

##### *Information Security and Privacy Risk*

As a financial institution, the Company is exposed to a variety of types of fraud and other financial crime, including cyber-crime. The scale, scope, complexity and velocity of these crimes is increasing, and could result in business interruptions, service disruptions, corporate espionage, theft of private and confidential information, and reputational damage. The Company is committed to investing in defensive technology, resources and processes to prevent, detect and manage information security and privacy threats.

##### *Third-party Risk*

The Company recognizes the value of using third parties to support its business activities, as they provide access to an expanded customer base, specialized expertise and systems, economies of scale and operational efficiencies. However, they also create reliance on the integrity, reliability, and security of these relationships, and their associated people, processes and technology. While the Company has implemented internal controls to manage the risks associated with key vendors as well as business partners such as mortgage brokers and loan servicers, failures could result in adverse effects including service disruptions, financial loss and damage to the Company's reputation.

### Other Factors That May Affect Future Results

##### *Change Management Risk*

The Company is embracing new technologies to improve service to the Company's customers and broker network, deliver efficiencies, strengthen internal controls and meet regulatory expectations. To manage the risk of change, the Company has employed structured processes such as its New Initiative Risk Assessment Process, as well as emphasizing stakeholder involvement and communication throughout the Company.



### ***Accounting Policies and Estimates Used by the Company***

The accounting policies and estimates the Company utilizes determine how the Company reports its financial condition and results of operations, and they may require management to make estimates or rely on assumptions about matters that are inherently uncertain. Such estimates and assumptions may require revisions, and changes to them may materially adversely affect the Company's results of operations and financial condition. More discussion is included in the Accounting Standards and Policies section of this MD&A and within the notes to the consolidated financial statements.

### **Risk Governance**

The Company's strategies and management of risk are supported by an overall enterprise risk management framework including policies, guidelines, and procedures for each major category of risk to which it is exposed. The Company defines risk management as an ongoing process involving the Board, management and other personnel in the identification, assessment, measurement, management and monitoring of risks that may positively or negatively impact the organization as a whole. Risk management is applied in strategy-setting across the enterprise and is designed to provide reasonable assurance that the Company's objectives can be realized given its stated risk appetite. The goal of the risk management framework is to support superior and sustainable business performance, including informed decision-making, improved deployment of capital, reduced frequency and severity of unanticipated events and losses, improved long-term business performance and increased stakeholder confidence.

Supporting the Company's risk management structure is a risk and compliance culture and a governance framework, including Board and senior management oversight and an increasingly robust set of risk policies and guidelines reflective of the Company's risk appetite that sets boundaries for acceptable business strategies, exposures and activities.

### **Risk and Compliance Culture**

The Company's risk and compliance culture is influenced by many factors and is supported by the following guiding principles:

#### ***Risk Governance***

- > Alignment and commitment to an effective three lines of defence model, including respective roles, responsibilities, accountabilities and effective challenge that is supported by strong Board oversight.
- > An effective system of controls commensurate with the size and complexity of the organization and consistent with regulatory expectations.
- > Decision-making is facilitated by engaging all relevant parties in the process to arrive at the best decision for the organization.

#### ***Risk Appetite***

- > The Company's risk appetite is forward-looking, reflects its strategic and financial objectives and informs enterprise and line of business decision-making.
- > Risk-reward balance is consistent with the Company's risk appetite.

#### ***Accountability***

- > Risk management structures and capabilities are embraced and add value to the business.
- > Business leaders are empowered to manage all aspects of their business and are held accountable for financial and risk results.

#### ***Capability***

- > The lines of business (first line) have the capability (people, information, tools, processes and models) to effectively measure and manage performance, risk and compliance.
- > Human capital decisions reflect risk and compliance competencies and behaviours.

#### ***Tone from the Top***

- > Board and senior management lead by example and promote adherence to the Company's risk appetite and compliance requirements, as well as a continuous improvement and learning culture.
- > Appropriate disciplinary actions are taken when necessary in response to compliance and internal policy breaches and Code of Conduct and Ethics violations.

#### ***Communication***

- > Risk and compliance culture is actively promoted (formally and informally) through multiple modes of communication and training to internal and external stakeholders.

#### ***Compensation and Incentives***

- > Employees are rewarded in a manner that encourages behaviour that is consistent with the Company's long-term strategic objectives, risk appetite, and adherence to compliance requirements.

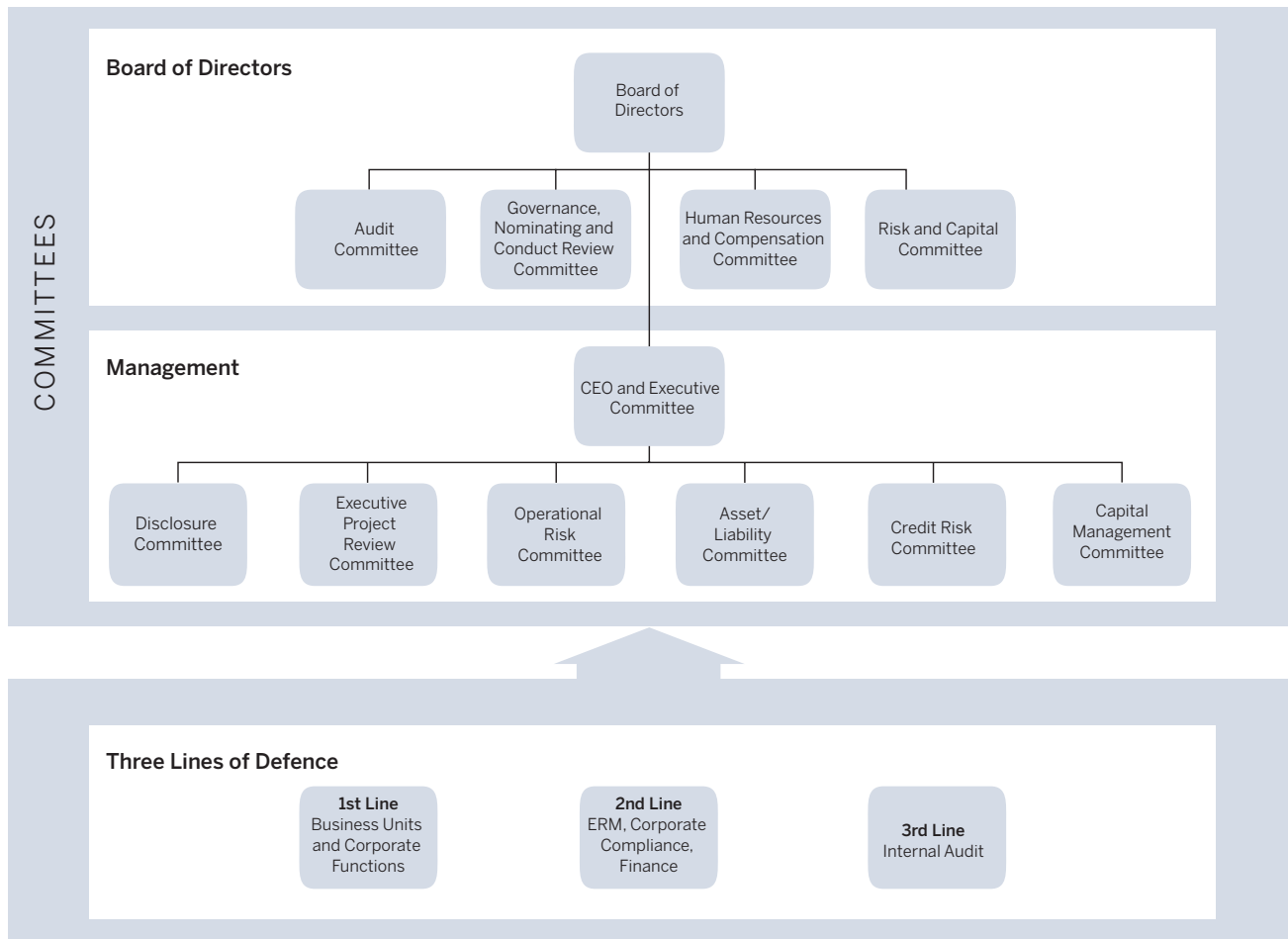
## MANAGEMENT'S DISCUSSION AND ANALYSIS

### Risk Governance Structure

The Company's risk governance is based on a three lines of defence model:

- > First Line of Defence – consists of the business units and corporate functions. As risk owners, management is accountable for identifying, assessing, measuring, managing, monitoring, and reporting on the risks generated within their respective areas of responsibility. Business risk management teams are embedded within the first line of defence to assist management in carrying out their risk and compliance responsibilities.
- > Second Line of Defence – consists of the Enterprise Risk Management and Corporate Compliance groups who are responsible for the establishment of the Company's risk management frameworks and the independent oversight of their implementation. Together with Finance, they are also responsible for the independent assessment, monitoring and reporting of risk-taking activities. Enterprise Risk Management and Corporate Compliance are independent from management. The Chief Risk Officer and Chief Compliance Officer are appointed by and report to the Risk and Capital Committee and Audit Committee, respectively.
- > Third Line of Defence – Internal Audit is responsible for providing independent, objective assurance to the Board and Executive Management by assessing the effectiveness of governance, risk management and control processes. The chief audit executive is appointed by and reports directly to the Audit Committee.

The risk governance structure depicted below ensures that there is a framework in place for risk oversight and accountability across the organization. Risk owners are responsible for developing and executing strategies for controlling risk.



The Board of Directors (the “Board”) is accountable for establishing the overall vision, mission, values, objectives and strategies of the Company and setting the Company’s overall risk-bearing capacity and risk appetite. The Board challenges management’s proposals and plans to ensure that the forecasted results and risk assessments are reasonable and in line with the Company’s capabilities, objectives and risk appetite. These risk management responsibilities are primarily carried out through the Risk and Capital Committee (RCC) of the Board. In this oversight role, the RCC is mandated to ensure that all significant risks to the Company, regardless of source, are proactively identified and effectively managed. This is accomplished by reviewing and approving, on at least an annual basis, all key risk policies; monitoring, on at least a quarterly basis, the Company’s actual risk profile against Board-approved risk appetite and limits; and providing direction to management when necessary. The RCC also provides oversight of the independence and effectiveness of the Company’s Enterprise Risk Management (ERM) function.

The Executive Committee (EC), chaired by the Chief Executive Officer, is responsible for recommending corporate strategy to the Board and for overseeing its execution. A critical component of its mandate is the implementation of the risk appetite and risk management frameworks. The EC is also accountable for implementation of an appropriate risk and compliance culture and monitoring the Company’s business activities, and providing risk oversight for strategic, reputational and compliance risks.

The most significant risks to the Company are subject to more specific review, monitoring and assessment under the mandates of supporting management risk committees. These committees (Credit Risk, Asset/Liability, Capital Management, Operational Risk, Disclosure, and Executive Project Review) recommend policies for approval as proposed by ERM and/or Corporate Compliance, proactively monitor and challenge management of specific risks under their mandates, and provide reporting to a Board Committee on risk profile compared to the Board-approved risk appetite and risk limits.

The ERM group is mandated to work with management and the Board to support sustainable business performance through the independent identification, measurement, monitoring and reporting of all significant risks to the Company, regardless of source. Working closely with management and the RCC, the ERM group recommends the Company’s overall risk appetite and limits, and develops and maintains an enterprise risk management framework and related risk governance structure to enable effective management of risk. It provides monitoring and oversight of the implementation of the risk appetite and risk management frameworks, including providing independent challenge and a current view of the Company’s risk profile by monitoring actual exposures against approved risk appetite, limits, policies and guidelines.

The Chief Compliance Officer (CCO), the Chief Anti-Money Laundering Officer (CAMLO) and the Corporate Compliance group are mandated to establish and maintain an enterprise-wide compliance framework (a set of controls and oversight processes) designed to mitigate the Company’s compliance risk. The Corporate Compliance group is an independent function that promotes a sound risk and compliance culture. The CCO and CAMLO are responsible for expressing an independent opinion to the Audit Committee on the status, adequacy and effectiveness of the Company’s state of compliance on a periodic basis.

Internal Audit is mandated to independently assess and report to the Audit Committee, the Board and Executive Management on the effectiveness of governance, risk management and internal control processes.

The Finance group is mandated to establish and maintain a financial management framework (a set of controls and oversight processes). In addition to the first line of defence responsibilities for implementing, monitoring and reporting on controls, the Finance group has second line of defence responsibilities relating to the oversight of the effectiveness of financial controls. The Chief Financial Officer reports to management and the Board, shareholders and regulators on the performance of the Company. The Finance group also updates the Company’s financial and capital plans with periodic forecasts, advises the Board of anticipated outcomes, and recommends revisions to capital plans and structures as appropriate.

## Risk Management

### Risk Appetite Statement

The Company’s risk appetite statement sets out the aggregate level and types of risk that the Company is willing to accept in order to achieve its business objectives. It considers the maximum level of risk that the Company can assume before breaching constraints determined by regulatory capital and liquidity needs, as well as the Company’s conduct with respect to depositors, customers, investors and other stakeholders. The risk appetite framework guides the risk-taking activities of the Company by establishing qualitative and quantitative benchmarks, parameters and limits related to the amount of risk the Company is willing to accept, considering financial, operational and macroeconomic factors.

The Company’s risk appetite statement articulates the following major enterprise principles.

The Company will:

- > Maintain adequate capital and liquidity at all times.
- > Only take risks that are transparent and manageable and that fit the Company’s business strategy.
- > Not expose itself to any significant single loss event on any individual transaction or acquisition.
- > Not take risks that are expected to result in significant volatility in earnings or shareholder returns.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

- > Conduct business with honesty, integrity, respect and high ethical standards.
- > Strive to protect the Company's reputation at all times, with all key stakeholders.
- > Adopt a risk-based approach for identifying, assessing, managing, mitigating and monitoring risk that meets regulatory requirements and expectations.
- > Not tolerate business activities that are not supported by appropriate processes and internal controls that are designed to detect, deter and prevent activity associated with financial crime, or maintain relationships with persons or entities believed to be engaged in illegal or illicit activities.
- > Incorporate risk and compliance measures into performance and reward measurement programs.

The risk appetite framework includes key risk appetite measures supported by management and management risk committee-level limit structures that provide forewarning capabilities intended to trigger management actions and mitigation plans before risk appetite limits are breached.

### Risk Policies and Limits

The Company maintains policies, guidelines, delegated lending authorities, risk limits and an internal control framework designed to ensure that business activities are conducted within the Company's risk appetite. Risk policies and guidelines are reviewed regularly and challenged by management risk committees, and key policies and frameworks are reviewed, challenged and approved by the Board.

The Company has identified the following eight principal risks, as illustrated below.

Principal Risk	Key Policy / Framework	Risk Limits	Management Oversight
Credit	Credit Risk Policy	Credit Concentration Limits	Credit Risk Committee
	Residential Mortgage Underwriting Policy	Delegated Lending Authorities	
Market	Market Risk Policy	Market Risk Limits	Asset/Liability Committee
Liquidity and Funding	Liquidity and Funding Risk Policy	Liquidity and Funding Risk Limits	Asset/Liability Committee
		Funding Concentration Limits	
Operational	Operational Risk Management Policy and Framework Internal Control Framework	Key Risk Indicators	Operational Risk Committee
			Disclosure Committee
			Executive Project Review Committee
Compliance	Corporate Compliance Policy Anti-Money Laundering and Anti-Terrorist Financing Policy	Key Risk Indicators	Executive Committee
Strategic	Strategic and Financial Planning Policy	Risk Appetite Statement	Executive Committee
Reputational	Reputational Risk Policy	Risk Appetite Statement	Executive Committee
Capital Adequacy	Capital Management Policy	Key Risk Indicators	Capital Management Committee

In addition to these principal risks, the Company employs a risk register to describe risk categories and related subcategories to facilitate consistent risk identification and provide a common starting point in developing risk management strategies and processes. These risks are identified, measured, assessed, and monitored on an ongoing basis, with regular reporting to risk committees of both senior management and the Board. Risks are mitigated through various actions to reduce the inherent risk to acceptable residual levels, as defined by the Company's risk appetite. Strategic and reputational risks are considered overarching risks, as substantial outcomes from other principal risks could pose significant second order impacts to the Company's reputation or ability to execute strategic objectives.

## Risk Identification and Assessment

The Company uses a range of risk tool programs to proactively identify its exposure to key risks and assesses the effectiveness of related mitigation strategies. Risk assessments are also performed on regulatory compliance management and significant new initiatives by business and support groups (e.g., products, services or technologies), and other internal subject matter experts.

## Risk Measurement

The ability to measure risks is a key component of the Company's risk management framework and capital management processes. The Company's risk measurement processes align with regulatory requirements such as liquidity measures, leverage ratios, capital adequacy and stress testing. While quantitative risk measurement is important, reliance is also placed on qualitative factors for those risk types that are difficult to quantify. The Company uses various risk measurement methodologies including scenario and sensitivity analysis, stress testing, risk limits, and internal and external operational risk event monitoring.

## Stress Testing

Management conducts regular stress testing, including stress testing through the Company's ICAAP, liquidity and funding planning, credit risk management and ad hoc stress testing to evaluate a range of extreme but plausible scenarios. Stress tests are conducted to determine the potential impact of these events, the effectiveness of management's contingency plans to deal with these unlikely but possible events, and management's ability to mitigate the potential risk. A common set of enterprise scenarios is developed to assess the impact on the Company's financial results, capital position, operational capabilities and the Company's ability to respond to the event. In particular, management has evaluated a range of stress scenarios, including a severe real estate price decline and interest rate shock. Management analyzes the outcomes from stress testing and, where applicable, takes proactive measures to mitigate potential risks to the business.

## Risk Monitoring and Reporting

Enterprise and business level risk monitoring and reporting processes are designed to ensure that risks and issues are identified, escalated and managed on a timely basis. The Company monitors external developments, key risk indicators and early warning indicators to identify and provide timely responses to emerging risk issues and other changes in risk profile before risk appetite limits are reached. ERM, management risk committees and the Board regularly monitor the Company's risk profile in relation to risk appetite and related limits, with timely escalation of issues requiring broader attention and/or approval.

In addition to the above, risk-specific presentations are provided to and discussed with management risk committees and the Board periodically.

The following sections describe the principal risk types and how they are managed.

## Credit Risk

Credit risk is the risk of the loss of principal and/or interest from the failure of debtors and/or counterparties to honour their financial or contractual obligations to the Company, for any reason. The Company's overall exposure to credit risk is governed by a defined credit-specific risk appetite, risk limits, a Board-approved Credit Risk Policy, delegated lending authorities, and regular independent monitoring and reporting. The Credit Risk Committee establishes, implements and monitors credit risk-related policies and guidelines enterprise-wide, considering business objectives, risk appetite, planned financial performance and risk profile. Credit risk limits are established for all types of credit exposures, with geographic, product, property and security type limits established to cover all material classes of exposure. The Company's Credit Risk Policy limits the total aggregate exposure to any entity or connection. The lines of business are responsible for managing the Company's credit risks in accordance with approved policies and guidelines, and assessing overall credit conditions and exposures on an ongoing basis. The Credit Risk Committee, Capital Management Committee, the ERM group, and the RCC of the Board provide oversight of the credit portfolio through ongoing reviews of credit risk management policies, lending practices, portfolio composition and risk profile, the adequacy of allowance for credit losses and the allocation of credit risk-based capital.

At a transactional level, loans are independently approved by credit and/or underwriting staff, commensurate with their experience and expertise to extend credit within the bounds of the Company's credit risk policies and limits delegated by ERM. A foundation of the Company's approach to credit is a high level of due diligence on each individual transaction, with oversight from a management team with strong industry experience. All transactions are subject to a detailed assessment of the borrower's ability to service the loan, credit history and underlying security. Enhanced due diligence is conducted on transactions deemed to carry higher credit risks based on pre-defined parameters. Transactions in excess of individual authority are approved by the Credit Risk Transactional Sub-Committee of the Credit Risk Committee and ultimately by the RCC of the Board as required.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

**Table 28: Credit Risk Portfolio Metrics**

(000s, except % and number of credit cards and lines of credit issued)	2018	2017	2016
Total loans balance (gross of allowance for credit losses)	\$ 16,264,387	\$ 14,903,689	\$ 17,960,600
<b>Mortgage Portfolio<sup>1</sup></b>			
Total mortgage balance (gross of allowance for credit losses)	\$ 15,540,312	\$ 14,190,461	\$ 17,210,830
Residential mortgages as a percentage of total mortgages	90.7%	92.6%	88.6%
Non-residential mortgages as a percentage of total mortgages	9.3%	7.4%	11.4%
Percentage of insured residential mortgages <sup>2</sup>	21.7%	24.0%	20.0%
Percentage of mortgages current	99.0%	99.4%	98.5%
Percentage of mortgages over 90 days past due	0.39%	0.27%	0.34%
Percentage of insured residential mortgage originations	16.1%	20.3%	27.7%
Loan-to-value ratio of residential mortgages (current uninsured) <sup>3</sup>	67.6%	68.9%	65.0%
<b>Credit Card and Lines of Credit Portfolio</b>			
Total credit card and lines of credit balance (gross of allowance for credit losses)	\$ 405,051	\$ 352,062	\$ 370,458
Percentage of Equityline Visa credit cards	87.6%	87.7%	86.6%
Percentage of secured credit cards	3.4%	4.3%	3.9%
Percentage of credit cards and lines of credit current	98.1%	98.1%	98.6%
Percentage of credit cards and lines of credit over 90 days past due	0.6%	0.7%	0.4%
Loan-to-value ratio of Equityline Visa (current) <sup>3</sup>	61.0%	61.2%	63.2%
Visa card security deposits	\$ 20,514	\$ 21,580	\$ 21,253
Total authorized limits of credit cards and lines of credit	\$ 760,290	\$ 497,475	\$ 515,947
Total number of credit cards and lines of credit issued	77,613	41,736	42,707
Average balance authorized	\$ 10	\$ 12	\$ 12

<sup>1</sup> Residential mortgages include single-family residential mortgages, multi-unit residential mortgages and other residential commercial mortgages.

<sup>2</sup> Insured loans are loans insured against default by CMHC or another approved insurer, either individually at origination or by portfolio.

<sup>3</sup> Loan-to-value ratio is calculated as the current balance outstanding to the appraised value at origination without any price adjustment. For Equityline Visa, loan-to-value ratio includes both the first mortgage and the secured Equityline Visa balance.

### Mortgage Lending

Credit risk mitigation is a key component of the Company's approach to credit risk management. The composition of the mortgage portfolio is well within the Company's risk appetite. Senior management and the ERM group closely monitor credit metrics and the performance of the mortgage loan portfolio. The portfolio continues to perform well, with arrears and net write-offs that are well within expected levels.

The Company mitigates credit risk by ensuring borrowers have the capacity and willingness to pay, as well as through collateral in the form of real property. Loan to value (LTV) is a key credit risk metric used in the Company's underwriting process. Please see Tables 31 and 32 for further information.

The Company separately monitors segments of its portfolio for indications of deterioration in performance. The Company continues to closely monitor market conditions and the performance of the high-rise condominium market. High-rise condominiums represent 7.7% of the residential mortgage portfolio and, of these, 24.8% are insured. The average current LTV of the high-rise condominium portfolio was 54.2% at the end of 2018. The credit performance of the high-rise condominium portfolio is strong and within the Company's expectations, with 99.1% of the portfolio current and 0.1% over 90 days past due.

The level of non-residential mortgages increased during the year. The proportion is well within the policy limits.

### Consumer Lending

Credit card and Equityline Visa balances were \$405.1 million at the end of the year, most of which are secured by either cash deposits or residential property. Within the credit card and lines of credit portfolio, Equityline Visa accounts, which are secured by residential property, represent the principal driver of receivable balances. The Equityline Visa portfolio had a weighted-average LTV at origination of 60.4% at the end of the year compared to 57.2% at the end of 2017. The LTV includes both the first mortgage and the secured Equityline Visa balance.

Senior management and the ERM group closely monitor the credit performance of the credit card and line of credit portfolio. The portfolio continued to perform well, with arrears well within expected levels. As of December 31, 2018, \$2.4 million or 0.6% of the credit card and line of credit portfolio was over 90 days in arrears, compared to \$2.3 million or 0.7% at December 31, 2017.

Other consumer retail loans are primarily secured by charges on financed assets or homes in which the financed assets are present, primarily automobiles and fixtures and/or improvements to residential property. These portfolios continued to perform well and within expected levels. Certain loans within the other consumer retail loan portfolio are advanced to the vendors who have underlying loans receivable from the end consumer. These loans are considered as commercial loans for purposes of underwriting and capital treatment. The Company holds a portion of the advanced amount on these loans as cash collateral.

Refer to Note 5(B) in the consolidated financial statements included in this report for a breakdown of the overall loan portfolio by geographic region.

### **Non-performing Loans, Credit Provisions and Allowances**

The Company adopted IFRS 9 on January 1, 2018, which resulted in significant changes to what the Company considers as non-performing loans and how provisions and allowances for credit losses are determined. The determination of allowances for credit losses under IFRS 9 involves a three-stage expected credit loss model. Stage 1 represents loans that are considered to be performing well with no significant deterioration in the risk of default. Stage 2 represents loans that are still considered to be performing but where there has been a significant increase in the risk of default. Stage 3 represents impaired (non-performing) loans where payments are generally more than 90 days past due or where there is other objective evidence of impairment. The determination of whether loans are considered as Stage 3 under IFRS 9 is similar conceptually to the determination of whether loans were non-performing under IAS 39. Please see Note 2 to the consolidated financial statements included in this report for more information on the determination of allowance for credit losses under IFRS 9.

Net non-performing loans remained within expected and acceptable ranges representing 0.47% of gross loans at the end of 2018.

Write-offs, net of recoveries, during the year totalled \$9.0 million or 0.06% of gross loans in 2018.

The Company has security in the form of real property or cash deposits for virtually the entire loan portfolio. Expected and unexpected future losses are mitigated with a combination of conservative loan-to-value ratios, risk-based pricing and a strong capital position.

The Company maintains an allowance for credit losses in accordance with IFRS 9 which represents management's best estimate of expected credit losses in the loan portfolio. The allowance is reviewed quarterly, at a minimum. Note 5 to the consolidated financial statements included in this report provides a continuity of the allowance for credit losses during the period by product and IFRS 9 Stage, indicating components of the provision for credit losses as well as write-offs and recoveries. The continuity disclosure also provides information pertaining to the movements between the IFRS 9 stages. Note 5 also provides a distribution of the gross carrying value of loans by product across five internal risk ratings for each of the IFRS 9 stages.

In addition to the allowance for credit losses, the risk of future losses is considered in the determination of the appropriate level of capital supporting the Company's operations. The Company holds capital for possible further credit losses. This includes capital required by regulation (see Table 24) and additional capital amounts as recommended by management and approved by the Board. The Company uses stress testing and scenario analysis to challenge the adequacy of the capital appropriated for credit risk. As at December 31, 2018, the Company held total regulatory capital at 185% of the regulatory minimum. A substantial portion of this is appropriated for credit risk.



## MANAGEMENT'S DISCUSSION AND ANALYSIS

### Additional Information: Residential Loans and Equityline Visa Home Equity Line of Credit (HELOC)

The tables below provide additional information on the composition of the Company's single-family residential mortgage portfolio by province and insured status, as well as by remaining effective amortization periods and loan-to-value ratios by province.

**Table 29: Single-family Residential Loans by Province (Gross of Allowance for Credit Losses)**

(000s, except %)							2018
	Insured Residential Mortgages <sup>1</sup>	Percentage of Total for Province	Uninsured Residential Mortgages	Percentage of Total for Province	Equityline Visa <sup>2</sup>	Percentage of Total for Province	Total
British Columbia	\$ 246,999	23.3%	\$ 804,847	76.1%	\$ 6,507	0.6%	\$ 1,058,353
Alberta	528,233	66.3%	259,776	32.6%	8,859	1.1%	796,868
Ontario	1,794,870	16.2%	8,964,756	80.8%	336,066	3.0%	11,095,692
Quebec	127,308	32.8%	260,034	67.0%	935	0.2%	388,277
Other	358,777	62.5%	212,959	37.1%	2,457	0.4%	574,193
	<b>\$ 3,056,187</b>	<b>22.0%</b>	<b>\$ 10,502,372</b>	<b>75.4%</b>	<b>\$ 354,824</b>	<b>2.6%</b>	<b>\$ 13,913,383</b>

(000s, except %)							2017
	Insured Residential Mortgages <sup>1</sup>	Percentage of Total for Province	Uninsured Residential Mortgages	Percentage of Total for Province	Equityline Visa <sup>2</sup>	Percentage of Total for Province	Total
British Columbia	\$ 255,452	33.8%	\$ 498,570	65.9%	\$ 2,390	0.3%	\$ 756,412
Alberta	387,436	59.2%	257,339	39.4%	9,057	1.4%	653,832
Ontario	1,834,007	17.2%	8,520,469	80.0%	294,622	2.8%	10,649,098
Quebec	113,804	33.7%	222,702	66.0%	1,058	0.3%	337,564
Other	242,158	63.0%	140,522	36.5%	1,803	0.5%	384,483
	<b>\$ 2,832,857</b>	<b>22.2%</b>	<b>\$ 9,639,602</b>	<b>75.4%</b>	<b>\$ 308,930</b>	<b>2.4%</b>	<b>\$ 12,781,389</b>

<sup>1</sup> See definition of insured loans under the Glossary of Terms in this report.

<sup>2</sup> Equityline Visa is an uninsured product.

**Table 30: Insured and Uninsured Single-Family Residential Mortgages by Effective Remaining Amortization Period (Gross of Allowance for Credit Losses)**

(000s, except %)							2018
	≤ 20 Years	> 20 and ≤ 25 Years	> 25 and ≤ 30 Years	> 30 and ≤ 35 Years	> 35 Years	Total	
Balance outstanding	\$ 1,333,431	\$ 2,666,307	\$ 9,547,074	\$ 10,501	\$ 1,246	\$ 13,558,559	
Percentage of total	9.8%	19.7%	70.4%	0.1%	0.0%	100.0%	

(000s, except %)							2017
	≤ 20 Years	> 20 and ≤ 25 Years	> 25 and ≤ 30 Years	> 30 and ≤ 35 Years	> 35 Years	Total	
Balance outstanding	\$ 882,444	\$ 2,460,171	\$ 9,092,962	\$ 35,597	\$ 1,285	\$ 12,472,459	
Percentage of total	7.1%	19.7%	72.9%	0.3%	0.0%	100.0%	

**Table 31: Weighted-Average Loan-to-Value Ratios for Uninsured Single-family Residential Mortgages Originated During the Year**

	2018		2017	
	Uninsured Residential Mortgages <sup>1</sup>	Equityline Visa <sup>1</sup>	Uninsured Residential Mortgages <sup>1</sup>	Equityline Visa <sup>1</sup>
British Columbia	64.2%	60.8%	63.0%	47.1%
Alberta	69.6%	63.3%	68.8%	56.3%
Ontario	69.8%	61.2%	70.9%	56.6%
Quebec	70.8%	68.4%	69.2%	24.5%
Other	70.7%	50.2%	69.6%	58.6%
Total	69.2%	61.1%	70.3%	56.5%

<sup>1</sup> Weighted-average LTV is calculated by dividing the sum of the products of LTVs and loan balances by the sum of the loan balances. LTVs are calculated using appraised property values at the time of origination.

The Company actively manages the mortgage portfolio and performs regular and ad-hoc stress testing. Stress testing includes scenarios that are based on a combination of increasing unemployment, rising interest rates, and a decline in real estate values, as well as specific operational, market and single-factor stress tests. The probability of default in the residential mortgage portfolio is most closely correlated with changes in employment rates. Consequently, during an economic downturn, either regionally or nationally, the Company would expect an increased rate of default and an increase in credit losses arising from lower real estate values. The Company's stress tests related to either regional or national economic downturns, which include declining housing prices and increased unemployment, indicate that the Company has sufficient capital to absorb such events, albeit with increases to credit losses. The total single-family residential mortgage portfolio including HELOC was \$13.91 billion as of December 31, 2018, of which \$3.06 billion was insured against credit losses.

The Company's key mitigant against credit losses in the event of default in the uninsured portfolio is the excess of the value of the collateral over the outstanding loan amount (expressed as LTV ratio). As at December 31, 2018, the weighted-average LTV of the uninsured portfolio against the estimated current market value was 59.0% compared to 55.3% at the end of 2017. These average current LTVs were estimated with appraised property values adjusted for price changes by using the Teranet-National Bank House Price Index. This index provides an estimate of changes in prices for all of Canada by region using the first three digits of the postal code in which the property is located, if available. If an economic downturn involved reduced real estate values, the margin of value over loan amounts would be eroded and the extent of loan losses could increase. The weighted-average LTV for each significant market is indicated below.

**Table 32: Weighted-Average Loan-to-Value Ratios for Uninsured Residential Mortgages**

	2018				2017	
	Weighted-average Current LTV <sup>1</sup>	Percentage of Total Value of Outstanding Mortgages with Current LTV Less Than or Equal To		Weighted-average Current LTV <sup>1</sup>	Percentage of Total Value of Outstanding Mortgages with Current LTV Less Than or Equal To	
		75%	65%		75%	65%
British Columbia	55.9%	95.1%	72.2%	49.6%	99.5%	90.0%
Alberta	64.1%	83.1%	51.7%	63.9%	84.9%	51.3%
Ontario	58.9%	84.6%	63.9%	55.2%	96.2%	74.2%
Quebec	61.0%	91.3%	62.4%	61.4%	94.8%	60.9%
Other	65.0%	75.7%	43.9%	61.7%	87.7%	53.9%
Total	59.0%	85.3%	63.8%	55.3%	95.9%	73.8%

<sup>1</sup> Weighted-average LTV is calculated by dividing the sum of the products of LTVs and loan balances by the sum of the loan balances.

### Market Risk

Market Risk is the potential for adverse changes in the value of assets, liabilities or earnings resulting from changes in market variables such as interest rates, equity prices and counterparty credit spreads. For the Company, market risk consists primarily of investment risk and structural interest rate risk. A summary of these risks is as follows:

### Investment Risk

Investment risk is the risk of loss of earnings and capital from changes in security prices and dividends in the investment portfolio, whether they arise from macroeconomic factors, the economic prospects of the issuer, or the availability of liquid markets, among other factors. The Company's investment portfolio consists primarily of government bonds at 93.2% of the portfolio and preferred shares at 6.8% of the portfolio. The total balance was \$386.3 million at December 31, 2018 compared to \$332.5 million at the end of 2017.

The Company's investment risk management framework is approved by the Asset/Liability Committee (ALCO) and the RCC. The ALCO is responsible for defining and monitoring the Company's investment portfolio and identifying investments that may be at risk of impairment. The ERM group conducts analysis of counterparties to assess if credit deterioration has resulted in an impairment of the investments. The Treasury group is responsible for managing the Company's investment portfolio in accordance with approved policies and assesses the impact of market events on potential implications to its total value. The ERM group recommends policies, reviews procedures and guidelines, and provides enterprise-wide oversight and challenge of investment risk, including valuations.

As of December 31, 2018, the Company assessed its securities portfolio for evidence of impairment and did not identify any negative credit events during the year in relation to its debt holdings (Refer to Note 4(C) in the consolidated financial statements included in this report).

## Structural Interest Rate Risk

Structural interest rate risk is the risk of lost earnings or capital due to changes in interest rates. The objective of interest rate risk management is to ensure that the Company can realize stable and predictable earnings over specific time periods despite interest rate fluctuations. The Company has adopted an approach to the management of its asset and liability positions to prevent interest rate fluctuations from materially impacting future earnings, and seeks to organically match liabilities to assets in terms of maturity and interest rate repricing through its actions in the deposit market in priority to accessing off-balance sheet solutions. The Company has significantly reduced the proportion of overall funding from high-interest savings demand deposits. This has significantly reduced the Company's risk of a funding mismatch. The Company has established prudent limits on the level of deposits that may comprise demand deposits.

The Company's market risk management framework includes interest rate risk policies that are approved by the ALCO and the RCC. The ALCO is responsible for defining and monitoring the Company's structural interest rate risk and reviewing significant maturity and/or duration mismatches, as well as developing strategies that allow the Company to operate within its overall risk appetite. In addition, the ALCO oversees stress testing of structural interest rate risk using a number of interest rate scenarios. The Treasury group is responsible for managing the Company's interest rate gaps in accordance with approved policies and assesses the impact of market events on the Company's net interest income and economic value of shareholders' equity. The ERM group recommends prudent policies and guidelines, and provides independent enterprise-wide oversight of all interest rate risk.

From time to time, the Company enters into derivative transactions to hedge interest rate exposure resulting from outstanding loan commitments on fixed-rate mortgages, deposits, and CMB liabilities. Where appropriate, the Company will apply hedge accounting to minimize volatility in reported earnings from interest rate changes. All derivative contracts are over-the-counter contracts with highly rated Canadian financial institutions. The use of derivative products has been approved by the Board; however, permitted usage is governed by specific policies. Derivatives are only permitted in circumstances in which the Company is hedging asset-liability mismatches, or loan commitments, or because of hedging requirements under the terms of its participation in the CMB program. The Company utilizes total return swaps to hedge restricted share units awarded to employees. Moreover, the policy expressly articulates that the use of derivatives is not permitted for transactions that are undertaken to potentially create trading profits through speculation on interest rate movements. Please see the Non-Interest Income section of this MD&A and Note 18 to the consolidated financial statements included in this report for further information on the Company's use of derivatives and hedging activities.

The Company is exposed to interest rate risk because of a difference, or gap, between the maturity or repricing date of interest-sensitive assets and liabilities. The following table shows the gap positions at December 31, 2018 and December 31, 2017 for selected period intervals. Figures in parentheses represent an excess of liabilities over assets, or a negative gap position.

This schedule reflects the contractual maturities of both assets and liabilities, adjusted for assumptions regarding the effective change in the maturity date because of a mortgage becoming impaired and for credit commitments. Over the lifetime of certain assets, some contractual obligations, such as residential mortgages, will be terminated prior to their stated maturity at the election of the borrower, by way of prepayments. Similarly, some contractual off-balance sheet mortgage commitments may be made but may not materialize. In measuring its interest rate risk exposure, the Company makes assumptions about these factors and monitors these against actual experience. Variable-rate assets and liabilities are allocated to a maturity category based on their interest repricing date.

**MANAGEMENT'S DISCUSSION AND ANALYSIS**
**Table 33: Interest Rate Sensitivity**

(thousands of Canadian dollars, except %)									As at December 31, 2018
	Floating Rate	0 to 3 Months <sup>1</sup>	3 to 6 Months	6 to 12 Months	1 to 5 Years	Over 5 Years	Non-interest Sensitive	Total	
<b>Assets</b>									
Cash and cash equivalents	\$ 206,043	\$ 459,904	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 665,947	
Weighted-average interest rate	1.7%	1.7%	—	—	—	—	—	1.7%	
Securities	—	—	—	4,905	381,428	—	—	386,333	
Weighted-average interest rate	—	—	—	3.6%	2.8%	—	—	2.8%	
Loans held for sale	—	—	—	—	—	130,351	—	130,351	
Weighted-average interest rate	—	—	—	—	—	3.0%	—	3.0%	
Securitized mortgages	—	976,053	87,162	159,913	1,577,495	—	(692)	2,799,931	
Weighted-average interest rate	—	3.4%	2.4%	2.4%	3.0%	—	—	3.1%	
Non-securitized mortgages and loans	—	3,470,576	2,218,503	4,472,544	3,220,110	37,160	(6,128)	13,412,765	
Weighted-average interest rate	—	5.4%	4.6%	5.1%	5.2%	9.6%	—	5.1%	
Other assets	120,905	174,836	2,230	6,050	—	—	442,341	746,362	
Weighted-average interest rate	1.9%	0.5%	2.1%	2.3%	—	—	—	0.5%	
<b>Total</b>	<b>\$ 326,948</b>	<b>\$ 5,081,369</b>	<b>\$ 2,307,895</b>	<b>\$ 4,643,412</b>	<b>\$ 5,179,033</b>	<b>\$ 167,511</b>	<b>\$ 435,521</b>	<b>\$ 18,141,689</b>	
Weighted-average interest rate	1.8%	4.5%	4.5%	5.0%	4.4%	4.5%	—	4.4%	
<b>Liabilities and shareholders' equity</b>									
Deposits	\$ 341,401	\$ 1,491,050	\$ 1,587,819	\$ 2,790,420	\$ 6,670,755	\$ —	\$ 95,645	\$ 12,977,090	
Weighted-average interest rate	2.1%	2.1%	2.4%	2.6%	2.7%	—	—	2.6%	
Securitization liabilities	—	1,186,666	47,983	23,350	1,601,327	—	—	2,859,326	
Weighted-average interest rate	—	2.0%	1.3%	2.0%	2.4%	—	—	2.2%	
Other liabilities	—	297,481	—	—	—	—	367,182	664,663	
Weighted-average interest rate	—	2.7%	—	—	—	—	—	1.2%	
Shareholders' equity	—	—	—	—	—	—	1,640,610	1,640,610	
Weighted-average interest rate	—	—	—	—	—	—	—	—	
<b>Total</b>	<b>\$ 341,401</b>	<b>\$ 2,975,197</b>	<b>\$ 1,635,802</b>	<b>\$ 2,813,770</b>	<b>\$ 8,272,082</b>	<b>\$ —</b>	<b>\$ 2,103,437</b>	<b>\$ 18,141,689</b>	
Weighted-average interest rate	2.1%	2.1%	2.4%	2.6%	2.7%	—	—	2.2%	
<b>Credit commitments</b>	<b>\$ (14,453)</b>	<b>\$ 2,106,172</b>	<b>\$ 672,093</b>	<b>\$ 1,829,642</b>	<b>\$ (3,093,049)</b>	<b>\$ 167,511</b>	<b>\$ (1,667,916)</b>	<b>\$ —</b>	
Weighted-average interest rate	—	(957,344)	227	23,125	850,843	83,149	—	—	
Weighted-average interest rate	—	5.5%	7.0%	5.9%	5.3%	2.9%	—	—	
<b>Interest rate sensitivity gap</b>	<b>\$ (14,453)</b>	<b>\$ 1,148,828</b>	<b>\$ 672,320</b>	<b>\$ 1,852,767</b>	<b>\$ (2,242,206)</b>	<b>\$ 250,660</b>	<b>\$ (1,667,916)</b>	<b>\$ —</b>	
<b>Cumulative gap</b>	<b>\$ (14,453)</b>	<b>\$ 1,134,375</b>	<b>\$ 1,806,695</b>	<b>\$ 3,659,462</b>	<b>\$ 1,417,256</b>	<b>\$ 1,667,916</b>	<b>\$ —</b>	<b>\$ —</b>	
Cumulative gap as a percentage of total assets	(0.1)%	6.3%	10.0%	20.2%	7.8%	9.2%	—	—	

**Table 33: Interest Rate Sensitivity (Continued)**

(thousands of Canadian dollars, except %)								As at December 31, 2017	
	Floating Rate	0 to 3 Months <sup>1</sup>	3 to 6 Months	6 to 12 Months	1 to 5 Years	Over 5 Years	Non-interest Sensitive	Total	
<b>Assets</b>									
Cash and cash equivalents	\$ 562,185	\$ 773,953	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 1,336,138	
Weighted-average interest rate	1.3%	1.2%	—	—	—	—	—	1.3%	
Securities	—	10	—	3,147	329,311	—	—	332,468	
Weighted-average interest rate	—	9.9%	—	6.4%	1.6%	—	—	1.8%	
Loans held for sale	—	—	—	—	—	165,947	—	165,947	
Weighted-average interest rate	—	—	—	—	—	2.9%	—	2.9%	
Securitized mortgages	—	1,297,012	145,838	301,889	1,248,511	—	—	2,993,250	
Weighted-average interest rate	—	2.7%	3.1%	4.7%	3.1%	—	—	3.1%	
Non-securitized mortgages and loans	—	2,664,609	2,044,506	4,252,340	2,903,822	17,987	(11,600)	11,871,664	
Weighted-average interest rate	—	5.0%	4.8%	5.2%	4.9%	8.7%	—	5.0%	
Other assets	59,402	367,877	9,146	7,911	—	—	447,340	891,676	
Weighted-average interest rate	1.0%	1.4%	0.5%	1.6%	—	—	—	0.7%	
<b>Total</b>	<b>\$ 621,587</b>	<b>\$ 5,103,461</b>	<b>\$ 2,199,490</b>	<b>\$ 4,565,287</b>	<b>\$ 4,481,644</b>	<b>\$ 183,934</b>	<b>\$ 435,740</b>	<b>\$ 17,591,143</b>	
Weighted-average interest rate	1.3%	3.6%	4.6%	5.1%	4.2%	3.5%	—	4.1%	
<b>Liabilities and shareholders' equity</b>									
Deposits	\$ 368,459	\$ 1,606,093	\$ 1,404,164	\$ 2,715,166	\$ 5,905,667	\$ —	\$ 170,905	\$ 12,170,454	
Weighted-average interest rate	1.4%	1.8%	2.2%	2.4%	2.4%	—	—	2.3%	
Securitization liabilities	—	1,324,280	162,538	303,047	1,387,884	—	—	3,177,749	
Weighted-average interest rate	—	1.7%	2.1%	3.7%	2.3%	—	—	2.1%	
Other liabilities	—	38,728	—	—	—	—	390,707	429,435	
Weighted-average interest rate	—	—	—	—	—	—	—	—	
Shareholders' equity	—	—	—	—	—	—	1,813,505	1,813,505	
Weighted-average interest rate	—	—	—	—	—	—	—	—	
<b>Total</b>	<b>\$ 368,459</b>	<b>\$ 2,969,101</b>	<b>\$ 1,566,702</b>	<b>\$ 3,018,213</b>	<b>\$ 7,293,551</b>	<b>\$ —</b>	<b>\$ 2,375,117</b>	<b>\$ 17,591,143</b>	
Weighted-average interest rate	1.4%	1.7%	2.2%	2.5%	2.4%	—	—	1.9%	
Credit commitments	\$ 253,128	\$ 2,134,360	\$ 632,788	\$ 1,547,074	\$ (2,811,907)	\$ 183,934	\$ (1,939,377)	\$ —	
Weighted-average interest rate	—	(844,583)	18,643	25,887	773,794	26,259	—	—	
Weighted-average interest rate	—	5.6%	5.7%	4.3%	4.5%	3.1%	—	—	
Interest rate sensitivity gap	\$ 253,128	\$ 1,289,777	\$ 651,431	\$ 1,572,961	\$ (2,038,113)	\$ 210,193	\$ (1,939,377)	\$ —	
Cumulative gap	\$ 253,128	\$ 1,542,905	\$ 2,194,336	\$ 3,767,297	\$ 1,729,184	\$ 1,939,377	\$ —	\$ —	
Cumulative gap as a percentage of total assets	1.4%	8.8%	12.5%	21.4%	9.8%	11.0%	—	—	

<sup>1</sup> Total assets in the 0–3 month category above included \$1.77 billion in variable rate mortgages (2017 – \$1.48 billion).

## MANAGEMENT'S DISCUSSION AND ANALYSIS

To assist in matching assets and liabilities, the Company utilizes a variety of metrics, including two interest rate risk sensitivity metrics that measure the relationship between changes in interest rates and the resulting estimated impact on both the Company's future net interest income and the economic value of shareholders' equity. The Company measures these metrics over many different yield curve scenarios.

The following table provides measurements of interest rate sensitivity and the potential after-tax impact of an immediate and sustained 100 basis-point increase or decrease in interest rates on net interest income and on the economic value of shareholders' equity and OCI.

**Table 34: Impact of Interest Rate Shifts**

(thousands of Canadian dollars)	<b>December 31 2018</b>	December 31 2017	<b>December 31 2018</b>	December 31 2017
	Increase in interest rates		Decrease in interest rates	
<b>100 basis point shift</b>				
Impact on net interest income, after tax (for the next 12 months)	\$ 5,039	\$ 2,418	\$ (5,039)	\$ (2,418)
Impact on net present value of shareholders' equity	17,688	(2,448)	(19,171)	1,952
Impact on other comprehensive income	2,670	2,243	(2,670)	(2,243)

As illustrated in the above table, a change in interest rates will have an impact on net interest income after tax and the economic value of shareholders' equity in the event of a 100 basis-point movement in rates without management action. A positive gap exists when interest-sensitive assets exceed interest-sensitive liabilities on specific maturity or repricing periods. As these gaps widen, the fluctuation in the interest rate sensitivity becomes more pronounced and, for this reason, the Company's ALCO manages this to within authorized limits.



## Liquidity and Funding Risk

Liquidity and funding risk is the risk that the Company is unable to generate or obtain sufficient cash or equivalents in a timely manner and at a reasonable cost to meet its financial obligations (both on- and off-balance sheet) as they fall due. This risk will arise from fluctuations in the Company's cash flows associated with lending, securitization, deposit-taking, investing and other business activities.

The High-Interest Savings Accounts and Oaken Savings Accounts add to liquidity risk as depositors can withdraw deposits on notice in the absence of fixed contractual terms. The Company's current exposure to this risk is within the Company's current risk appetite. The Company has a \$500 million committed secured standby credit facility from a syndicate of Canadian chartered banks to strengthen its liquidity position. Please see Note 4(A) to the consolidated financial statements included in this report for details on this credit facility. The Company believes the current level of liquidity and credit facilities are sufficient to support ongoing business for the foreseeable future. As indicated in Table 18, maturities of non-securitized loans are in excess of deposit maturities for the next 12 months. The Company strategically limits demand deposits to an appropriate level that is aligned with the Company's liquidity and funding limits, taking into consideration that a primary purpose of the Oaken Savings Accounts is to facilitate the seamless movement of funds to and from Oaken GICs for customers.

The Company's liquidity risk management framework includes a three-year enterprise funding plan, liquidity and funding risk policies, and a Contingency Funding Plan that are approved by the ALCO and the RCC. The mandate of the ALCO includes establishing and recommending to the Board an enterprise-wide liquidity risk appetite. In addition, the ALCO reviews the composition and term structure of assets and liabilities, reviews liquidity and funding risk policies and strategies and regularly monitors compliance with those policies. The ALCO also oversees the stress testing of liquidity and funding risk and the testing of the Company's Contingency Funding Plan. The Treasury group is responsible for managing the Company's liquidity and funding risk positions in accordance with approved policies and assesses the impact of market events on liquidity requirements on an ongoing basis. The ERM group recommends liquidity policies and guidelines, and provides independent oversight of all liquidity and funding risk.

The Company's annual three-year funding plan assesses future funding needs and how the Company intends to fulfill these requirements as measured against the Company's risk appetite. Securing sustainable diversified funding at a reasonable cost and acceptable level of liquidity risk is fundamental to the Company realizing its future growth potential.

The Company's liquidity and funding risk policies are designed to ensure that cash balances and the inventory of other liquid assets are sufficient to meet all cash outflows both in ordinary market conditions and during periods of extreme market stress. The Company's policies address several key elements, such as the minimum levels of liquid assets to be held at all times; the composition of types of liquid assets to be maintained; daily monitoring of the liquidity position by Treasury, senior management, and the ERM group; monthly reporting to the ALCO; and quarterly reporting to the RCC.

The Company uses a liquidity horizon as its main liquidity metric. Using maturity gap analysis, the Company projects a time horizon when its net cumulative cash flow turns negative, after taking into account the market value of its stock of liquid assets. The Company's liquidity horizon is calculated daily and is based upon contractual and behavioural cash flows. Forecasts are made using normal market conditions and a number of stressed liquidity scenarios, including ability to fund, term deposit runoff, demand deposit runoff, loan growth, liquidity portfolio valuation, loan arrears and write-downs. In addition, the Company regularly monitors a number of other structural liquidity and funding ratios in its overall liquidity and funding risk management framework.

The Company holds liquid assets in the form of cash, bank deposits, securities issued or guaranteed by the Government of Canada, securities issued by provincial governments, and highly rated short-term money market securities, corporate bonds and debentures. The Company's liquid assets are presented in the table below:

**Table 35: Liquidity Resources**

(000s, except %)	2018	2017
Cash and cash equivalents per balance sheet	\$ 665,947	\$ 1,336,138
Securities per balance sheet	386,333	332,468
Add: MBS and CMB included in residential mortgages	262,005	17,046
	<b>1,314,285</b>	1,685,652
Less: securities held for investments	(26,352)	(30,934)
Liquid assets at carrying value	<b>\$ 1,287,933</b>	\$ 1,654,718
Liquid assets at fair value	<b>\$ 1,290,857</b>	\$ 1,654,665
Liquid assets at carrying value as a % of total assets	<b>7.1%</b>	9.4%

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Certain Company-originated NHA MBS are held as liquid assets but are classified in residential mortgages on the balance sheet, as required by IFRS. The underlying mortgages are insured and the securities are stamped by CMHC. On an overall basis, liquidity resources fluctuate as the Company's future cash requirements change.

The Company's main sources of funding come from retail deposits and securitization. Retail deposits are primarily sourced through the deposit broker network and the Company relies heavily on this channel. The majority of these deposits are received through channels that are controlled by several of the major Canadian banks. The broker network provides the Company with access to a very large volume of potential deposits, which are sourced almost entirely from individual investors. The bulk of deposits raised are CDIC-insured fixed-term GICs that are not subject to early redemption. The Company has contractual agreements with most major national investment dealers and a large number of independent brokers.

The Company continues its longer-term strategy to diversify its sources of funding through its direct-to-consumer brand, Oaken Financial, and its bank subsidiary, Home Bank. The Company will restrict its funding through demand deposits such as high-interest savings accounts.

The Company is an Approved NHA MBS Issuer and an Approved Seller into the CMB program, which are securitization initiatives sponsored by CMHC. Securitization funding provides the Company with long-term matched funding at attractive interest rates. Traditionally, the Company has used securitization markets to fund its Accelerator mortgages and insured multi-unit residential mortgages and, to a lesser extent, its traditional mortgages that qualified for bulk portfolio insurance. On-balance sheet Accelerator mortgages and multi-unit residential mortgages classified as held for sale are generally held for securitization and are funded with deposits or lines of credit until securitized. When mortgages are securitized, the Company receives principal and interest payments on its underlying mortgage loans before the required payments are passed-through to MBS investors. However, as a part of its servicing obligations, the Company must pass-through on a timely basis any payments that are not collected due to arrears. In the case of defaults, the Company would make required payments to investors and place the mortgage/property through the insurance claims process to recoup any losses. This could result in cash flow timing mismatches that could marginally increase liquidity and funding risk.

### OSFI Liquidity Requirements

As required by OSFI's Liquidity Adequacy Requirements (LAR), the Company reports its Liquidity Coverage Ratio (LCR) to OSFI, which is a minimum regulatory liquidity standard adopted by OSFI. The LCR requires net cumulative cash flow requirements in a stressed environment. As well, the Company reports the OSFI-designed Net Cumulative Cash Flow (NCCF), which measures detailed cash flows to capture the risk posed by funding mismatches over and up to a 12-month time horizon. The Company complies with these requirements.

### Operational Risk

Operational risk, which is inherent in all business activities, is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The impact of operational risk may include financial loss, reputational harm, or regulatory enforcement actions, among other impacts. Operational risk is inherent in every business and support activity, including the practices for managing other risks such as credit, compliance and liquidity and funding risks. The Company has taken proactive steps to mitigate this risk in order to create and sustain shareholder value, execute on business strategies and operate effectively. Strategies to manage operational risk include the deployment of risk managers into the business lines, and mitigation by controls as well as risk avoidance, transfer, and acceptance. Oversight of the operational risk framework is provided by the ERM group, the Operational Risk Committee, and the Audit Committee and RCC of the Board.

The Company continues to strengthen its operational risk framework which includes the following components:

- > Risk and control self-assessments are applied at the line-of-business level as well as for significant processes in the Company. Business process mapping supports the analysis of risks and controls at the process level.
- > The new initiative risk assessment process requires risks to be identified and assessed for new initiatives including new or changed products, processes and systems, joint ventures and other corporate development activities.
- > Subject-matter experts with expertise in privacy, security, data governance, legal, and other areas have been designated to assist in risk assessments.
- > Risks are monitored on an ongoing basis through the use of key risk indicators that have established limits and thresholds aligned with the Company's risk appetite.
- > Internal and external operational risk events are regularly reported along with root cause analysis and action plans as required.
- > Risk-mitigation action plans established for identified risks are regularly tracked and reported.
- > Stress testing and scenario analysis have included scenarios such as earthquakes, pandemics, cyber-attacks, active shooters, and fraud scenarios.
- > Information/Cyber Security, Business Continuity Management and Data Recovery programs have been established and are subject to regular testing.
- > Through the model risk management program, key models are independently vetted and validated before use, and model performance is monitored on an ongoing basis.

- > The Data Governance program is focused on providing accurate, complete and timely information to support decision making.
- > Third-party risk management programs require that appropriate risk assessment and due diligence be performed before engaging in business with third-party service providers and on a periodic basis going forward.
- > The Company manages a portfolio of insurance and other risk mitigating arrangements. The insurance terms and provisions, including types and amounts of coverage in the portfolio, are continually assessed to ensure that both the Company's tolerance for risk and, where applicable, statutory requirements are satisfied.

## Compliance Risk

Compliance risk refers to the risk of non-compliance with laws, regulations, guidelines, an undertaking to a regulatory authority or provision, section, subsection, order, term or condition, including related internal policies and procedures. This includes requirements that have been identified by the EC and senior management that require the Company to do certain things, including conducting its affairs in a particular manner, and where non-compliance could have an impact on the Company's reputation and/or safety and soundness.

While all business units and corporate functions of the Company (as the first line of defence) are responsible for ensuring that compliance risk (including but not limited to anti-money laundering, anti-fraud, ethics and conduct, privacy and sanctions) is mitigated, the independent oversight of compliance risk is principally managed by the CCO, CAMLO and the Corporate Compliance group as part of the Company's Regulatory Compliance Framework.

Home Capital is subject to the continuous disclosure requirements of applicable Canadian provincial and territorial securities legislation and the rules of the Toronto Stock Exchange (TSX) and, in accordance therewith, files periodic reports and other information with Canadian provincial and territorial securities regulators and the TSX relating to its business, financial condition and other matters. These reports and information may be accessed through SEDAR at [www.sedar.com](http://www.sedar.com). Under the TLCA, regulated entities like Home Trust are prohibited from disclosing, directly or indirectly, any "prescribed supervisory information" relating to it or its affiliates, with certain limited exceptions. "Prescribed supervisory information" is defined broadly in terms of (i) assessments, recommendations, ratings and reports concerning the Company that are made by or at the request of OSFI; (ii) any category in which the Company is classified under the CDIC Differential Premiums By-Laws, any premium rate assigned to it and any annual premium determined for it under that By-law; and (iii) certain regulatory actions taken with respect to the Company.

## Capital Adequacy Risk

Capital adequacy is a key requirement in the safety and soundness of any financial institution. Capital is the difference between the Company's assets and liabilities, and acts as a financial cushion to absorb unexpected losses. Capital adequacy risk is the risk that the Company does not hold sufficient capital required to manage enterprise-wide risks as a going concern, even in periods of severe but plausible stress. Not maintaining sufficient capital adequacy may lead to insolvency and creditor (depositor) losses. Please refer to the Capital Management section of this MD&A for further information.

Oversight of the management of capital adequacy risk is provided by the ERM group, Finance, the Capital Management Committee and the RCC of the Board.

## Strategic Risk

Strategic risk is the risk to earnings, capital or corporate value arising from making inappropriate strategic choices, lack of responsiveness to changes in the financial services and operating environment, or the inability to successfully implement selected strategies, related plans and decisions. Strategic risk is managed by the EC. On a regular basis, the EC reviews the current business environment, including regulatory developments and the actions of the Company's competitors, and adjusts business plans accordingly. The Board approves the Company's strategies at least annually and reviews results against those strategies at least quarterly.

## Reputational Risk

Reputational risk is the risk that stakeholder impressions, whether true or not, regarding the Company's business practices, actions or inactions, will adversely affect the Company's earnings, economic value, capital, or ability to maintain existing or establish new business relationships and continued access to sources of funding.

The objective of reputational risk management is to protect and enhance the Company's reputation by building and maintaining stakeholder confidence and trust that the Company can deliver on its promises. The Company has adopted a reputational risk management framework which provides an overview of its approach for this type of risk, focusing on risk management principles, stakeholder management, and organizational accountabilities for the prevention and detection of reputational risk vulnerabilities. The Company's approach to the management of this risk combines the experience and knowledge applied in the management of other risk types with a corporate understanding of potential consequences to the Company. Oversight is provided by the EC and the RCC of the Board.

## Accounting Standards and Policies

The significant accounting policies are outlined in Note 2 to the consolidated financial statements included in this report. These policies are critical as they refer to material amounts and require management to make estimates.

Management has exercised judgement in the process of applying the Company's accounting policies. Some of the Company's accounting policies require subjective, complex judgements and estimates relating to matters that are inherently uncertain. The preparation of the consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the consolidated balance sheet dates and the reported amounts of revenue and expenses during the reporting periods.

### Derecognition of Financial Assets

Management has applied judgement in the application of its accounting policy with respect to derecognition of the loans and other assets used in current securitization programs. Certain securitized loans are recognized only to the extent of the Company's continuing involvement, based on management's judgement that it cannot be determined whether substantially all the risks and rewards of ownership have been transferred while control has been retained as defined by IFRS 9. In other cases, when residual interests in securitized transactions are sold, the underlying securitized loans are derecognized based on management's judgement that substantially all the risks and rewards of ownership have been transferred through the two transactions. The remaining loans and other assets that have been securitized are not derecognized, based on management's judgement that the Company has not transferred substantially all of the risks and rewards of ownership of the loans and other assets.

### Impairment of Financial Assets

Under IFRS 9, the expected credit loss (ECL) model requires management to make judgements and estimates in a number of areas. Management must exercise significant judgement in determining whether there has been a significant increase in credit risk (SICR) since initial recognition and in estimating the amount of expected credit losses. The calculation of expected credit losses includes the incorporation of forward-looking information, which requires significant judgement to determine the forward-looking variables that are relevant for each portfolio and the scenarios and probability weights that should be applied. Management also exercises expert credit judgement in determining the amount of ECLs at each reporting date by considering reasonable and supportable information that is not already incorporated in the quantitative modelling process. Changes in these inputs, assumptions, models and judgements directly impact the measurement of ECLs.

### Impairment of Intangible Assets

In applying judgement in its assessment of impairment of intangible assets, management has considered the asset usage, obsolescence and impact on that assessment of the decline in the Company's common share price to below the book value per common share. While impairments were recognized on intangible assets as a result of usage and obsolescence, management does not consider the current common share price to warrant the recognition of additional impairment in its intangible assets as at the date of the consolidated financial statements. Management will continue to assess the implications of the common share price remaining below book value on its assessment of impairment of intangible assets.

### Other Judgements and Estimates

Other key areas where management has applied judgement and made estimates include fair values, income taxes, fair value of stock options, useful lives of capital assets and intangible assets, and provisions and contingent liabilities. Actual results could differ from those estimates.

Further information can be found under Notes 2, 4, 5, 6, 9, 10, 13, 16, 17, 18 and 20 to the consolidated financial statements included in this report.

### Current and Future Changes in Accounting Standards

Changes in accounting policies applied in 2018 along with the impact on the consolidated financial statements are discussed in Note 3 to the consolidated financial statements included in this report. The new IFRS pronouncements that have been issued but are not yet effective and may have a future impact on the Company are also discussed in Note 3 to the consolidated financial statements included in this report.

### Comparative Consolidated Financial Statements

The comparative consolidated financial statements included in this report have been reclassified from statements previously presented to conform to the presentation of the 2018 consolidated financial statements. In particular, loan balances previously presented net of individual allowances have been reclassified to a gross presentation. Similar reclassifications to a gross presentation have been made in this MD&A.

# Controls Over Financial Reporting

## Disclosure Controls and Internal Control over Financial Reporting

Management is responsible for establishing the integrity and fairness of financial information presented in the consolidated financial statements prepared in accordance with Canadian generally accepted accounting principles (GAAP). As such, management has established disclosure controls and procedures and internal controls over financial reporting to ensure that the Company's consolidated financial statements and Management's Discussion and Analysis present fairly, in all material respects, the financial position of the Company and the results of its operations.

## Disclosure Controls and Procedures

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is gathered and reported to senior management, including the Chief Executive Officer and Chief Financial Officer, on a timely basis so that appropriate decisions can be made regarding public disclosure.

An evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures was conducted as of December 31, 2018. Based on that evaluation, the Company's management, including the Chief Executive Officer and Chief Financial Officer, concluded that the Company's disclosure controls and procedures, as defined by National Instrument 52-109, *Certification of Disclosure in Issuers' Annual and Interim Filings*, were effective as of December 31, 2018.

## Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. The Company's internal controls over financial reporting includes policies and procedures that:

- > Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- > Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and receipts and expenditures are being made in accordance with the authorizations of management and the Board; and
- > Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Due to inherent limitations, internal controls over financial reporting can provide only reasonable assurance and may not prevent or detect misstatements. As a result, the Company's management acknowledges that its internal controls over financial reporting will not prevent or detect all misstatements due to error or fraud. Furthermore, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of a change in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

The Company has used the Committee of Sponsoring Organizations of the Treadway Commission (COSO) 2013 framework and COBIT, an IT governance framework, to evaluate the design of the Company's internal controls over financial reporting.

An evaluation of the design and operating effectiveness of internal controls over financial reporting was conducted as of December 31, 2018. Based on that evaluation, the Company's management, including the Chief Executive Officer and Chief Financial Officer, concluded that the Company's internal controls over financial reporting were operating effectively as of December 31, 2018.

## Changes in Internal Control over Financial Reporting

There were no significant changes in 2018 that have affected or could reasonably be expected to materially affect internal control over financial reporting.

## Non-GAAP Measures and Glossary

### Non-GAAP Measures

The Company uses a number of financial measures to assess its performance. Some of these measures are not calculated in accordance with GAAP, are not defined by GAAP, and do not have standardized meanings that would ensure consistency and comparability between companies using these measures. The non-GAAP measures used in this MD&A are defined as follows:

#### Allowance as a Percentage of Non-Performing Gross Loans

Allowance as a percentage of gross loans is calculated as the total allowance divided by the gross on-balance sheet non-performing loans outstanding, which includes all on-balance sheet loans except for loans held for sale.

#### Common Equity Tier 1, Tier 1, and Total Capital Ratios

The capital ratios provided in this MD&A are those of the Company's wholly owned subsidiary Home Trust. The calculations are in accordance with guidelines issued by OSFI. Refer to the Capital Management section of this MD&A and Note 13(F) to the consolidated financial statements included in this report.

#### Dividend Payout Ratio

Dividend payout ratio is a measure of the proportion of a Company's earnings that is paid to shareholders in the form of dividends. The Company calculates its dividend payout ratio as the amount of dividends per share as a percentage of diluted earnings per share.

#### Efficiency Ratio

Management uses the efficiency ratio as a measure of the Company's efficiency in generating revenue. This ratio represents non-interest expenses as a percentage of total revenue, net of interest expense. The Company looks at the ratio on a taxable equivalent basis and will include this adjustment in arriving at the efficiency ratio, on a taxable equivalent basis. A lower ratio indicates better efficiency.

#### Leverage Ratio

The Leverage ratio provided in this MD&A is that of the Company's wholly owned subsidiary Home Trust. The calculations are in accordance with guidelines issued by OSFI. The Leverage ratio is defined as the Capital Measure divided by the Exposure Measure, with the ratio expressed as a percentage. The Capital Measure is the all-in Tier 1 capital of Home Trust. The Exposure Measure consists of on-balance sheet assets, derivative, securities financing transactions and off-balance sheet exposures.

#### Liquid Assets

Liquid assets are unencumbered high-quality assets for which there is a broad and active secondary market available to the Company to sell these assets without incurring a substantial discount. Liquid assets are a dependable source of cash used by the Company when it experiences short-term funding shortfalls.

#### Market Capitalization

Market capitalization is calculated as the closing price of the Company's common shares multiplied by the number of common shares of the Company outstanding.

#### Net Interest Margin (Non-TEB)

Net interest margin is a measure of profitability of assets. Net interest margin (non-TEB) is calculated by taking net interest income divided by the average total assets.

#### Net Interest Margin (TEB)

Net interest margin is a measure of profitability of assets. Net interest margin (TEB) is calculated by taking net interest income, on a taxable equivalent basis, divided by the average total assets.

### **Net Non-performing Loans as a Percentage of Gross Loans (NPL Ratio)**

The NPL ratio is calculated as the total net non-performing loans divided by the gross on-balance sheet loans, which includes all on-balance sheet loans except for loans held for sale.

### **Provision as a Percentage of Gross Loans (PCL Ratio)**

The PCL ratio is calculated as the total provision expense divided by the gross on-balance sheet loans outstanding, which includes all on-balance sheet loans except for loans held for sale.

### **Provision as a Percentage of Gross Uninsured Loans**

The provision as a percentage of gross uninsured loans ratio is calculated as the total provision expense divided by the gross on-balance sheet uninsured loans outstanding.

### **Return on Average Assets (ROA)**

Return on average assets is a profitability measure that presents the annualized net income as a percentage of the average total assets for the period.

### **Return on Shareholders' Equity (ROE)**

ROE is calculated on an annualized basis and is defined as net income available to common shareholders as a percentage of average common shareholders' equity.

### **Risk-weighted Assets (RWA)**

The risk-weighted assets reported in this MD&A are those of the Company's wholly owned subsidiary Home Trust. The calculations are in accordance with guidelines issued by OSFI. Refer to the Capital Management section in this MD&A and Note 13(F) to the consolidated financial statements included in this report.

### **Taxable Equivalent Basis (TEB)**

Most banks and trust companies analyze and discuss their financial results on a taxable equivalent basis (TEB) to provide uniform measurement and comparison of net interest income. Net interest income (as presented in the consolidated statements of income) includes tax-exempt income principally from preferred and common equity securities. The adjustment to TEB used in this MD&A increases income and the provision for income taxes to what they would have been had the income from tax-exempt securities been taxed at the statutory tax rate. TEB adjustments of \$0.5 million for 2018 (\$1.1 million – 2017) increased interest income as used in the calculation of net interest margin. Net interest margin is discussed on a TEB throughout this MD&A. See Table 4 for the calculation of net interest income on a TEB.

### **Total Assets under Administration (AUA)**

Total assets under administration refers to all on-balance sheet assets, plus all off-balance sheet loans that qualify for derecognition under IFRS.

### **Total Loans under Administration (LUA)**

Total loans under administration refers to all on-balance sheet loans, plus all off-balance sheet loans that qualify for derecognition under IFRS.

### **Total Revenue**

Total revenue is a measure of the revenue, net of interest expense, earned by the Company before non-interest expenses, provision for credit losses and income taxes. Total revenue is the sum of interest and dividend income, net of interest expense, and non-interest income.



### Glossary of Terms

**Assets or Loans under Administration** refer to assets or loans administered by a financial institution that are beneficially owned by clients and therefore not reported on the balance sheet of the administering financial institution, plus all assets or loans beneficially owned by the Company and carried on the balance sheets.

**Basis Point** is one-hundredth of a percentage point.

**Canada Deposit Insurance Corporation (CDIC)** is a Canadian federal Crown corporation created to protect qualifying deposits made with member financial institutions in case of their failure.

**Derivatives** are a contract between two parties, which requires little or no initial investment and where payments between the parties are dependent upon the movements in price of an underlying instrument, index or financial rate. Examples of derivatives include swaps, options, forward rate agreements and futures. The notional amount of the derivative is the contract amount used as a reference point to calculate the payments to be exchanged between the two parties, and the notional amount itself is generally not exchanged by the parties.

**Forwards** used by the Company are contractual agreements to either buy or sell a specified amount of an interest-rate-sensitive financial instrument or security at a specific price and date in the future. Forwards are customized contracts transacted in the over-the-counter market.

**Hedging** is a risk management technique used by the Company to neutralize, manage or offset interest rate, equity, or credit exposures arising from normal banking activities.

**Impaired or Non-performing Loans** are loans for which there is no longer reasonable assurance of the timely collection of principal or interest. The Company considers its non-performing loans to be those determined as Stage 3 under IFRS 9. Please see Note 2 to the consolidated financial statements included in this report for more information.

**Insured Loans** are loans insured against default by CMHC or another approved insurer, either individually at origination or by portfolio. The Company's insured lending includes single-family homes and multi-unit residential properties.

**Net Interest Income** comprises earnings on assets, such as loans and securities, including interest and dividend income, less interest expense paid on liabilities, such as deposits.

**Notional Amount** refers to the principal used to calculate interest and other payments under derivative contracts. The principal does not change hands under the terms of a derivative contract.

**Office of the Superintendent of Financial Institutions Canada (OSFI)** is the government agency responsible for regulation and supervision of banks, insurance companies, trust companies, loan companies and pension plans in Canada.

**Securitization** is the practice of selling pools of contractual debts, such as residential or commercial mortgages, to third parties.

**Swaps** are contractual agreements between two parties to exchange a series of cash flows. The Company uses interest rate swaps and total return swaps. An interest rate swap is an agreement where counterparties generally exchange fixed-rate and floating-rate interest payments based on a notional value in a single currency. A total return swap is an agreement in which one party makes payments based on a set rate, either fixed or variable, while the other party makes payments based on the return of an underlying asset, which includes both the income it generates and any capital gains.

## Acronyms

<b>ALCO</b>	– Asset/Liability Committee
<b>AOCI</b>	– Accumulated Other Comprehensive Income
<b>CDIC</b>	– Canada Deposit Insurance Corporation
<b>CMB</b>	– Canada Mortgage Bond
<b>CMHC</b>	– Canada Mortgage and Housing Corporation
<b>COSO</b>	– Committee of Sponsoring Organizations of the Treadway Commission
<b>CVA</b>	– Credit Valuation Adjustment
<b>ERM</b>	– Enterprise Risk Management
<b>GAAP</b>	– Generally Accepted Accounting Principles
<b>GIC</b>	– Guaranteed Investment Certificate
<b>HELOC</b>	– Home Equity Line of Credit
<b>IASB</b>	– International Accounting Standards Board
<b>IFRS</b>	– International Financial Reporting Standards
<b>LTV</b>	– Loan to Value (ratio expressed as a percentage)
<b>MBS</b>	– Mortgage-Backed Security
<b>MD&amp;A</b>	– Management's Discussion and Analysis
<b>N/A</b>	– Not Applicable for the respective period
<b>NCCF</b>	– Net Cumulative Cash Flow
<b>NHA</b>	– National Housing Act
<b>OCI</b>	– Other Comprehensive Income
<b>OSFI</b>	– Office of the Superintendent of Financial Institutions Canada
<b>TEB</b>	– Taxable Equivalent Basis
<b>TLCA</b>	– <i>Trust and Loan Companies Act (Canada)</i>

## CONSOLIDATED FINANCIAL STATEMENTS

(unless otherwise stated, all amounts are in Canadian dollars)

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## MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL INFORMATION

The consolidated financial statements and Management's Discussion and Analysis (MD&A) of Home Capital Group Inc. (the "Company") were prepared by management, which is responsible for the integrity and fairness of the financial information presented. The consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles for publicly accountable enterprises, which are International Financial Reporting Standards as issued by the International Accounting Standards Board, including the accounting requirements specified by the Office of the Superintendent of Financial Institutions Canada that apply to its subsidiaries, Home Trust Company and Home Bank. The consolidated financial statements reflect amounts which must, of necessity, be based on the best estimates and judgement of management with appropriate consideration as to materiality. The financial information presented elsewhere in this report is consistent with that in the consolidated financial statements. The MD&A has been prepared according to the requirements of securities regulators.

Management is responsible for ensuring the fairness and integrity of the financial information. It is also responsible for the implementation of the supporting accounting systems. In discharging its responsibilities, management maintains the necessary internal control systems designed to provide assurance that the transactions are properly authorized, assets are safeguarded and proper accounting records are held. The controls include quality standards in hiring and training of employees, written policies, authorized limits for managers, procedure manuals, a corporate code of conduct and ethics and appropriate management information systems. Management has formed a disclosure committee, chaired by the Chief Financial Officer, which reviews all the Company's financial disclosures for fairness before being released to the Board of Directors or shareholders.

The internal control systems are further supported by a compliance framework, which ensures that the Company and its employees comply with all regulatory requirements, as well as by an enterprise risk management function that monitors proper risk control, related documentation and the measurement of the financial impact of risks. In addition, the internal audit function periodically assesses various aspects of the Company's operations and makes recommendations to management for, among other things, improvements to the control systems. As at December 31, 2018, the Company's Chief Executive Officer and Chief Financial Officer have determined that the Company's internal control over financial reporting is effective.

Every year, the Office of the Superintendent of Financial Institutions Canada makes such examinations and inquiries as deemed necessary to satisfy itself that Home Trust Company and Home Bank are in a sound financial position and that they comply with the provisions of the *Trust and Loan Companies Act* (Canada) and *Bank Act* (Canada).

Ernst & Young LLP, independent auditors, appointed by the shareholders, perform an annual audit of the Company's consolidated financial statements and their report follows.

The internal auditors, the Chief Compliance Officer, the external auditors and the Office of the Superintendent of Financial Institutions Canada meet periodically with the Audit Committee and/or the Board of Directors, with management either present or absent, to discuss all aspects of their duties and matters arising therefrom.

The Board of Directors is responsible for reviewing and approving the consolidated financial statements and Management's Discussion and Analysis of results of operations and financial condition appearing in the Annual Report. It oversees the manner in which management discharges its responsibilities for the presentation and preparation of financial statements, maintenance of appropriate internal controls, and risk management as well as assessment of significant transactions and related party transactions through its Audit Committee, and in the case of risk management, through the Risk and Capital Committee. The Audit Committee is composed solely of independent Directors. The Audit Committee is responsible for selecting the shareholders' auditors.



**Yousry Bissada**

*President and Chief Executive Officer*  
Toronto, Canada  
February 21, 2019



**Brad Kotush, CPA, CA**

*Chief Financial Officer*

## INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Home Capital Group Inc.

### Opinion

We have audited the consolidated financial statements of Home Capital Group Inc. (the Company), which comprise the consolidated balance sheets as at December 31, 2018 and 2017, and the consolidated statements of income, consolidated statements of comprehensive income, consolidated statements of changes in shareholders' equity and consolidated statements of cash flows for the years then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as at December 31, 2018 and 2017, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards (IFRSs).

### Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### Other Information

Management is responsible for the other information. The other information comprises:

- > Management's Discussion and Analysis
- > The information, other than the consolidated financial statements and our auditor's report thereon, in the Annual Report.

Our opinion on the consolidated financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon. In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

We obtained Management's Discussion and Analysis prior to the date of this auditor's report. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact in this auditor's report. We have nothing to report in this regard.

The Annual Report is expected to be made available to us after the date of the auditor's report. If, based on the work we will perform on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact to those charged with governance.

### Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRSs, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

## Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.


As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- > Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- > Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- > Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- > Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- > Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this independent auditor's report is Helen Mitchell.

The logo for Ernst & Young LLP, featuring the company name in a stylized, handwritten-style font.

**Chartered Professional Accountants**

Licensed Public Accountants

Toronto, Canada

February 21, 2019

## CONSOLIDATED BALANCE SHEETS

	As at	
thousands of Canadian dollars	December 31 2018	December 31 2017
<b>ASSETS</b>		
<b>Cash and Cash Equivalents</b> (note 4(A))	\$ 665,947	\$ 1,336,138
<b>Securities</b> (notes 4(B) and (C))	386,333	332,468
<b>Loans Held for Sale</b>	130,351	165,947
<b>Loans</b> (note 5)		
Securitized mortgages (note 6(A))	2,800,623	2,993,250
Non-securitized mortgages and loans	13,463,764	11,910,439
	16,264,387	14,903,689
Allowance for credit losses <sup>1</sup> (note 5(C))	(51,691)	(38,775)
	16,212,696	14,864,914
<b>Other</b>		
Restricted assets (note 7)	309,205	437,011
Derivative assets (note 18)	8,925	7,325
Other assets (note 8)	338,987	336,770
Deferred tax assets (note 16(C))	3,489	9,577
Goodwill and intangible assets (notes 9 and 10)	85,756	100,993
	746,362	891,676
	\$ 18,141,689	\$ 17,591,143
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Liabilities</b>		
<b>Deposits</b> (note 11)	\$ 12,977,090	\$ 12,170,454
<b>Securitization Liabilities</b> (note 6(B))		
CMHC-sponsored mortgage-backed security liabilities	1,573,216	1,562,152
CMHC-sponsored Canada Mortgage Bond liabilities	1,239,331	1,473,318
Bank-sponsored securitization conduit liabilities	46,779	142,279
	2,859,326	3,177,749
<b>Other</b>		
Credit facilities (note 4(A))	261,506	—
Derivative liabilities (note 18)	35,975	38,728
Other liabilities (note 12)	338,344	360,477
Deferred tax liabilities (note 16(C))	28,838	30,230
	664,663	429,435
	16,501,079	15,777,638
<b>Shareholders' Equity</b>		
Capital stock (note 13)	178,782	231,156
Contributed surplus	4,583	4,978
Retained earnings	1,467,730	1,583,265
Accumulated other comprehensive loss (note 15)	(10,485)	(5,894)
	1,640,610	1,813,505
	\$ 18,141,689	\$ 17,591,143

<sup>1</sup> The allowance for credit losses as at December 31, 2018 represents expected credit losses and has been prepared in accordance with IFRS 9 *Financial Instruments* (IFRS 9). The allowance for credit losses as at December 31, 2017 represents the total of individual and collective allowances on loan principal as prepared in accordance with the incurred loss model under IAS 39 *Financial Instruments: Recognition and Measurement* (IAS 39). Please see Note 2 for further information including information on reclassification of comparative balances.

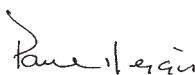
### Commitments and Contingencies (note 17)

The accompanying notes are an integral part of these consolidated financial statements.

On behalf of the Board:



**Yousry Bissada**  
President and Chief Executive Officer



**Paul Haggis**  
Chair of Audit Committee



## CONSOLIDATED STATEMENTS OF INCOME

	For the year ended	
	December 31 2018	December 31 2017
thousands of Canadian dollars, except per share amounts		
<b>Net Interest Income Non-Securitized Assets</b>		
Interest from loans <sup>1</sup> (note 5(H))	\$ 644,370	\$ 710,926
Dividends from securities	1,255	3,117
Other interest	24,735	15,267
	<b>670,360</b>	729,310
Interest on deposits and other	314,496	294,685
Interest and fees on line of credit facilities (note 4(A))	17,310	148,213
Net interest income non-securitized assets	<b>338,554</b>	286,412
<b>Net Interest Income Securitized Loans and Assets</b>		
Interest income from securitized loans and assets <sup>1</sup> (note 5(H))	94,537	89,929
Interest expense on securitization liabilities	80,691	73,411
Net interest income securitized loans and assets	<b>13,846</b>	16,518
<b>Total Net Interest Income</b>	<b>352,400</b>	302,930
Provision for credit losses <sup>1</sup> (note 5(C))	20,377	7,516
	<b>332,023</b>	295,414
<b>Non-Interest Income (Loss)</b>		
Fees and other income	47,806	67,932
Securitization income (note 6(C))	10,540	12,529
Gain on sale of PSiGate (note 22)	950	—
Net realized and unrealized gains (losses) on securities and loans (notes 4(C) and 5(J))	5,467	(90,070)
Net realized and unrealized gains (losses) on derivatives (note 18)	1,689	(2,010)
	<b>66,452</b>	(11,619)
	<b>398,475</b>	283,795
<b>Non-Interest Expenses</b>		
Salaries and benefits	76,924	98,595
Premises	10,168	13,878
Other operating expenses (note 9)	130,981	162,407
	<b>218,073</b>	274,880
<b>Income Before Income Taxes</b>	<b>180,402</b>	8,915
Income taxes (note 16(A))		
Current	43,103	(2,475)
Deferred	4,696	3,863
	<b>47,799</b>	1,388
<b>NET INCOME</b>	<b>\$ 132,603</b>	\$ 7,527
<b>NET INCOME PER COMMON SHARE</b> (note 13(E))		
Basic	\$ 1.66	\$ 0.10
Diluted	\$ 1.66	\$ 0.10
<b>AVERAGE NUMBER OF COMMON SHARES OUTSTANDING</b> (note 13(E))		
Basic	79,748	72,349
Diluted	79,748	72,358
Total number of outstanding common shares (note 13(B))	62,065	80,246
Book value per common share	\$ 26.43	\$ 22.60

<sup>1</sup> The amounts pertaining to 2018 have been prepared in accordance with IFRS 9; prior period amounts have not been restated and have been prepared in accordance with IAS 39. Please see Note 2 for further information.

The accompanying notes are an integral part of these consolidated financial statements.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

For the year ended

thousands of Canadian dollars	<b>December 31 2018</b>	December 31 2017
<b>NET INCOME</b>	<b>\$ 132,603</b>	<b>\$ 7,527</b>
<b>OTHER COMPREHENSIVE INCOME (LOSS)</b>		
<b>ITEMS THAT WILL NOT BE SUBSEQUENTLY RECLASSIFIED TO NET INCOME</b>		
<b>Equity Securities Designated at FVOCI<sup>1</sup></b>		
Change in net unrealized gains or losses	<b>(4,583)</b>	N/A
Income tax recovery	<b>(1,222)</b>	N/A
	<b>(3,361)</b>	N/A
<b>ITEMS THAT WILL BE SUBSEQUENTLY RECLASSIFIED TO NET INCOME</b>		
<b>Available for Sale Securities and Retained Interests<sup>1</sup></b>		
Net change in unrealized gains or losses	N/A	19,878
Net losses reclassified to net income	N/A	46,650
	N/A	66,528
Income tax expense	N/A	17,644
	N/A	48,884
<b>Debt Instruments at FVOCI<sup>1</sup></b>		
Net change in unrealized gains or losses	<b>(2,024)</b>	N/A
Net gains reclassified to net income	<b>918</b>	N/A
	<b>(1,106)</b>	N/A
Income tax recovery	<b>(293)</b>	N/A
	<b>(813)</b>	N/A
<b>Cash Flow Hedges (note 18)</b>		
Net change in unrealized gains or losses	<b>(1,278)</b>	(721)
Net losses reclassified to net income	<b>710</b>	1,120
	<b>(568)</b>	399
Income tax (recovery) expense	<b>(151)</b>	112
	<b>(417)</b>	287
Total other comprehensive (loss) income	<b>(4,591)</b>	49,171
<b>COMPREHENSIVE INCOME</b>	<b>\$ 128,012</b>	<b>\$ 56,698</b>

<sup>1</sup> The amounts pertaining to 2018 have been prepared in accordance with IFRS 9; prior period amounts have not been restated and have been prepared in accordance with IAS 39. N/A indicates not applicable under the accounting policy for the respective period. FVOCI indicates fair value through other comprehensive income. Please see Note 2 for further information.

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY<sup>1</sup>

thousands of Canadian dollars	Capital Stock	Contributed Surplus	Retained Earnings	Net Unrealized Gains (Losses), After Tax, on:			Total Accumulated Other Comprehensive Loss	Total Shareholders' Equity
				Equity Securities Designated at FVOCI	Debt Instruments at FVOCI	Cash Flow Hedges		
<b>Balance at January 1, 2018<sup>2</sup></b>	\$ 231,156	\$ 4,978	\$ 1,583,265	\$ (6,902)	\$ 2,197	\$ (1,189)	\$ (5,894)	\$ 1,813,505
Comprehensive income	—	—	132,603	(3,361)	(813)	(417)	(4,591)	128,012
Amortization of fair value of employee stock options (note 14(C))	—	(395)	—	—	—	—	—	(395)
Repurchase of shares (note 13(C))	(52,374)	—	(248,138)	—	—	—	—	(300,512)
<b>Balance at December 31, 2018</b>	<b>\$ 178,782</b>	<b>\$ 4,583</b>	<b>\$ 1,467,730</b>	<b>\$ (10,263)</b>	<b>\$ 1,384</b>	<b>\$ (1,606)</b>	<b>\$ (10,485)</b>	<b>\$ 1,640,610</b>

thousands of Canadian dollars, except per share amounts	Capital Stock	Contributed Surplus	Retained Earnings	Net Unrealized Losses on Securities and Retained Interests Available for Sale, After Tax	Net Unrealized Losses on Cash Flow Hedges, After Tax	Total Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Comprehensive income	—	—	7,527	48,884	287	49,171	56,698
Stock options settled (notes 13(B) and 14(C))	548	(141)	—	—	—	—	407
Amortization of fair value of employee stock options (note 14 (C))	—	557	—	—	—	—	557
Repurchase of shares (note 13(C))	(267)	—	(5,732)	—	—	—	(5,999)
Issuance of shares (note 13(D))	145,965	—	—	—	—	—	145,965
Dividends (\$0.26 per share)	—	—	(16,710)	—	—	—	(16,710)
<b>Balance at December 31, 2017</b>	<b>\$ 231,156</b>	<b>\$ 4,978</b>	<b>\$ 1,583,265</b>	<b>\$ (4,705)</b>	<b>\$ (1,189)</b>	<b>\$ (5,894)</b>	<b>\$ 1,813,505</b>

<sup>1</sup> The amounts pertaining to 2018 have been prepared in accordance with IFRS 9; prior period amounts have not been restated and have been prepared in accordance with IAS 39.

<sup>2</sup> Please see Note 2 for information on transition of balances as at December 31, 2017 to balances as at January 1, 2018 upon adoption of IFRS 9.

The accompanying notes are an integral part of these consolidated financial statements.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the year ended	
thousands of Canadian dollars	December 31 2018	December 31 2017
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income for the year	\$ 132,603	\$ 7,527
Adjustments to determine cash flows relating to operating activities:		
Amortization of net premium (discount) on securities	398	(330)
Provision for credit losses	20,377	7,516
(Recovery) loss on sale of loan portfolios	(4,451)	18,160
Gain on sale of PSiGate	(950)	—
Gain on sale of mortgages or residual interest	(4,633)	(5,695)
Net realized and unrealized (gains) losses on securities	(1,016)	71,910
Amortization and impairment losses <sup>1</sup>	23,049	34,345
Amortization of fair value of employee stock options	(395)	557
Deferred income taxes	4,696	3,863
Changes in operating assets and liabilities		
Loans, net of gains or losses on securitization and sales	(1,327,930)	2,947,462
Restricted assets	127,806	(171,637)
Derivative assets and liabilities	(4,921)	65,836
Accrued interest receivable	(5,818)	10,613
Accrued interest payable	29,032	3,666
Deposits	806,636	(3,715,576)
Credit facilities	261,506	—
Securitization liabilities	(318,423)	528,100
Taxes receivable or payable and other	(42,405)	13,086
Cash flows used in operating activities	(304,839)	(180,597)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Issuance of shares	—	145,965
Repurchase of shares	(300,512)	(5,999)
Exercise of employee stock options	—	407
Dividends paid to shareholders	—	(16,710)
Cash flows (used in) provided by financing activities	(300,512)	123,663
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Activity in securities		
Purchases	(472,349)	(378,123)
Proceeds from sales	412,407	491,883
Proceeds from maturities	838	84,919
Net proceeds from the sale of PSiGate	310	—
Purchases of capital assets	(1,622)	(1,715)
Capitalized intangible development costs	(4,424)	(9,286)
Cash flows (used in) provided by investing activities	(64,840)	187,678
Net (decrease) increase in cash and cash equivalents during the year	(670,191)	130,744
Cash and cash equivalents at beginning of the year	1,336,138	1,205,394
<b>Cash and Cash Equivalents at End of the Year</b> (note 4(A))	<b>\$ 665,947</b>	<b>\$ 1,336,138</b>
<b>Supplementary Disclosure of Cash Flow Information</b>		
Dividends received on investments	\$ 1,281	\$ 4,542
Interest received	758,196	825,030
Interest paid	383,465	512,643
Income taxes paid	65,379	3,002

<sup>1</sup> Amortization and impairment losses include amortization on capital and intangible assets and impairment losses on intangible assets and goodwill.

The accompanying notes are an integral part of these consolidated financial statements.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(unless otherwise stated, all amounts are in Canadian dollars)

# 1. Corporate Information

Home Capital Group Inc. (the "Company" or "Home Capital") is a public corporation traded on the Toronto Stock Exchange. The Company is incorporated and domiciled in Canada with its registered and principal business offices located at 145 King Street West, Suite 2300, Toronto, Ontario. The Company operates primarily through its federally regulated subsidiary, Home Trust Company (Home Trust), which offers residential and non-residential mortgage lending, securitization of insured residential mortgage products and consumer lending. Home Bank, a wholly owned subsidiary of Home Trust, is a federally regulated retail bank offering mortgage lending and securitization of insured residential mortgages. Home Trust and Home Bank also offer deposits via brokers and financial planners, and through a direct-to-consumer deposit brand, Oaken Financial. The Company's former subsidiary, Payment Services Interactive Gateway Inc. (PSiGate), provided payment services. On February 1, 2018, the Company closed the sale of PSiGate. Licensed to conduct business across Canada, Home Trust and Home Bank have offices in Ontario, Alberta, British Columbia, Nova Scotia, Quebec and Manitoba. The Company is the ultimate parent of the group.

These consolidated financial statements for the year ended December 31, 2018 were authorized for issuance by the Board of Directors (the Board) of the Company on February 21, 2019. The Board has the power to amend the consolidated financial statements after their issuance only in the case of discovery of an error.

# 2. Summary of Significant Accounting Policies

The consolidated financial statements of the Company have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) for publicly accountable enterprises, which are International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

The accounting policies were consistently applied to all periods presented unless otherwise noted (please see Current Period Changes to Accounting Policies below for more information). The significant accounting policies used in the preparation of these consolidated financial statements are summarized below.

## Comparative Consolidated Financial Statements

The comparative consolidated financial statements have been reclassified from statements previously presented to conform to the presentation of the 2018 consolidated financial statements. In particular, loan balances previously presented net of individual allowances have been reclassified to a gross presentation.

## Use of Judgement and Estimates

Management has exercised judgement in the process of applying the Company's accounting policies. Some of the Company's accounting policies require subjective, complex judgements and estimates relating to matters that are inherently uncertain. The preparation of these consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the consolidated balance sheet dates and the reported amounts of revenue and expenses during the reporting periods.

## Derecognition of Financial Assets

Management has applied judgement in the application of its accounting policy with respect to derecognition of the loans and other assets used in current securitization programs. Certain securitized loans are recognized only to the extent of the Company's continuing involvement, based on management's judgement that it cannot be determined whether substantially all the risks and rewards of ownership have been transferred while control has been retained as defined by IFRS 9 *Financial Instruments* (IFRS 9). In other cases, when residual interests in securitized transactions are sold, the underlying securitized loans are derecognized based on management's judgement that substantially all the risks and rewards of ownership have been transferred through the two transactions. The remaining loans and other assets that have been securitized are not derecognized, based on management's judgement that the Company has not transferred substantially all of the risks and rewards of ownership of the loans and other assets.

## Impairment of Financial Assets

Under IFRS 9, the expected credit loss (ECL) model requires management to make judgements and estimates in a number of areas. Management must exercise significant judgement in determining whether there has been a significant increase in credit risk (SICR) since initial recognition and in estimating the amount of expected credit losses. The calculation of expected credit losses includes the incorporation of forward-looking information, which requires significant judgement to determine the forward-looking variables that are relevant for each portfolio and the scenarios and probability weights that should be applied. Management also exercises expert credit judgement in determining the amount of ECLs at each reporting date by considering reasonable and supportable information that is not already incorporated in the quantitative modelling process. Changes in these inputs, assumptions, models and judgements directly impact the measurement of ECLs.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(unless otherwise stated, all amounts are in Canadian dollars)

### Impairment of Intangible Assets

In applying judgement in its assessment of impairment of intangible assets, management has considered the asset usage, obsolescence and impact on that assessment of the decline in the Company's common share price to below the book value per common share. While impairments were recognized on intangible assets as a result of usage and obsolescence, management does not consider the current common share price to warrant the recognition of additional impairment in its intangible assets as at the date of these consolidated financial statements. Management will continue to assess the implications of the common share price remaining below book value on its assessment of impairment of intangible assets.

### Other Judgements and Estimates

Other key areas where management has applied judgement and made estimates include fair values, income taxes, fair value of stock options, useful lives of capital assets and intangible assets, and provisions and contingent liabilities. Actual results could differ from those estimates.

### Principles of Consolidation

The consolidated financial statements include the assets, liabilities and results of operations of the Company and all of its subsidiaries, after the elimination of intercompany transactions and balances.

The Company consolidates those entities, including structured entities, which the Company controls. The Company has control when it has power over the entity, has exposure or rights to variable returns from its involvement and has the ability to use its power over the entity to affect returns. The structured entities included in the consolidated financial statements are those created in connection with the Company's credit facilities as described in Note 4(A). The subsidiaries included in the consolidated financial statements are Home Trust and Home Bank. Home Trust is a wholly owned subsidiary of Home Capital Group. Home Bank is a wholly owned subsidiary of Home Trust. PSiGate was a wholly-owned subsidiary of Home Capital Group and was included in the consolidated financial statements prior to its sale, which closed on February 1, 2018, as described in Note 22.

### Financial Instruments

On January 1, 2018, the Company adopted IFRS 9 *Financial Instruments* (IFRS 9), which replaces IAS 39 *Financial Instruments: Recognition and Measurement* (IAS 39). IFRS 9 includes requirements for classification and measurement of financial assets and liabilities, impairment of financial assets and general hedge accounting. Please see Note 3 for more information including the impact of adoption of IFRS 9 on the consolidated financial statements.

The Company, as permitted, did not restate comparative period financial information upon adoption of IFRS 9. Accordingly, where applicable, the accounting policies pertaining to financial instruments presented below specify both the accounting policies followed under IFRS 9 for 2018 and the accounting policies followed under IAS 39 for periods prior to 2018, along with information on the comparison of IFRS 9 and IAS 39 where relevant. Unless specified, the Company's accounting policies for financial instruments under IFRS 9 remain unchanged from IAS 39.

### Classification and Measurement of Financial Instruments

Under IFRS 9, all financial assets are classified at initial recognition based on the Company's business model under which the financial assets are managed and the nature and characteristics of its contractual cash flows. These factors determine whether financial assets are measured at amortized cost, fair value through other comprehensive income (FVOCI) or fair value through profit or loss (FVTPL). These categories replaced the IAS 39 classifications of held for trading, available for sale, loans and receivables, and held to maturity. Please see Note 15 for illustration of the reclassification to the new IFRS 9 categories that pertain to accumulated other comprehensive income (AOCI) and Note 20 for the categorization and fair value of financial assets and liabilities under IFRS 9 for 2018 and IAS 39 for 2017.

The IFRS 9 classification and measurement model requires all debt instrument financial assets that do not meet the solely payment of principal and interest (SPPI) test, including those that contain embedded derivatives, to be classified at initial recognition as FVTPL. For debt instrument financial assets that meet the SPPI test, classification at initial recognition is determined based on the business model under which the instruments are managed. Debt instruments that are managed on a hold to collect basis are classified at amortized cost, debt instruments that are managed on a held for trading or fair value basis are classified as FVTPL, and debt instruments that are managed on a held to collect and for sale basis are classified as FVOCI.

The Company has assessed the cash flow characteristics for in scope financial assets and defined its significant business models. In determining its business models, the Company considers a variety of factors at a portfolio level including management intent and strategic objectives, measurement and reporting of performance, frequency and volume of sales activity, and risk management methodology. The Company has determined the following business models:

- > Held to collect: the objective is to collect contractual cash flows, sales are incidental to the objective of the model.
- > Held to collect and for sale: the objective is to both collect contractual cash flows and sell the financial asset, and there is an expectation of higher frequency and volume of sales occurring than held to collect.
- > Held for sale and other: the objective is neither of the first two business models, the collection of contractual cash flows is incidental.

### Debt Instrument Financial Assets Measured at Amortized Cost

Debt instrument financial assets are managed on a held to collect basis, where their contractual cash flows meet the SPPI test and are measured at amortized cost. These financial assets are initially recognized at fair value plus direct and incremental transaction costs, and are subsequently measured at amortized cost, using the effective interest rate method, net of an allowance for expected credit loss. Debt instrument financial assets measured at amortized cost include most loans that were previously classified as loans and receivables under IAS 39, including residential and commercial mortgages, credit cards and other consumer retail loans. Mortgages that are securitized but do not receive off-balance sheet treatment are also measured at amortized cost. Debt instrument financial assets measured at amortized cost also include acceptable securities assigned as replacement assets in the Company's Canada Mortgage Bond program, which were previously recognized as available for sale securities under IAS 39. The replacement assets are investment-grade instruments similar to Government of Canada bonds and no credit losses are expected.

### Debt Instrument Financial Assets Measured at FVOCI

Debt instrument financial assets measured at FVOCI are non-derivative financial assets with contractual cash flows that meet the SPPI test and are managed on a held to collect and for sale basis. FVOCI debt instruments are measured initially at fair value plus direct and incremental transaction costs. Subsequent to initial recognition, similarly to available for sale debt instruments under IAS 39, under IFRS 9 cumulative gains or losses from changes in fair value are recognized in AOCI and changes in expected credit loss allowances are recognized in the consolidated statements of income. Upon derecognition of the debt instrument, cumulative gains or losses are transferred from AOCI to the consolidated statements of income. Debt instrument financial assets measured at FVOCI include debt securities, acquired residual interests of underlying securitized residential mortgages and the Company's retained interest held on mortgages that are securitized and sold. Government of Canada bonds and equivalents that are investment-grade are included under debt securities and no credit losses are expected.

### Equity Financial Instruments Designated at FVOCI

Equity financial instruments are measured at FVTPL unless an irrevocable designation is made to measure them at FVOCI. Gains or losses from changes in the fair value of equity instruments designated at FVOCI are recognized in other comprehensive income (OCI). In contrast to available for sale equity securities under IAS 39, amounts recognized as OCI are not subsequently recycled to profit or loss, with the exception of interests and dividends. Instead, cumulative gains or losses upon derecognition of the equity instrument are transferred within shareholders' equity from AOCI to retained earnings and presented in the consolidated statements of changes in shareholders' equity. Consequently, the recognition of impairment losses is not required. Equity financial instruments designated at FVOCI include non-trading equity securities held by the Company and consist primarily of preferred shares.

### Financial Instruments Measured at FVTPL (Trading and Non-trading)

Trading financial instruments are measured at FVTPL as they are held for trading purposes. Non-trading financial assets are also measured at FVTPL if their contractual cash flow characteristics do not meet the SPPI test or if they are managed on a fair value basis. Trading and non-trading financial assets are remeasured at each reporting date. Gains and losses on disposition and the associated unrealized gains and losses as a result of remeasurement are recognized in the consolidated statements of income as non-interest income. Interest income and expenses recognized on trading and non-trading financial instruments are recognized in net interest income. Financial instruments measured at FVTPL include cash and cash equivalents, derivative instruments held, and mortgages originated or purchased with the intention of being securitized and sold.

### Cash and Cash Equivalents

For the purposes of the consolidated financial statements, cash and cash equivalents comprise balances with less than 90 days to maturity, including cash and deposits with regulated financial institutions, treasury bills and other eligible deposits. Cash and deposits are carried at fair value and classified as financial instruments measured at FVTPL, as indicated above. Interest income is recognized using the effective interest rate method and, to the extent not received at year-end, is recorded as a receivable in other assets on the consolidated balance sheets.

### Loans

As indicated above, most loans are classified as debt instrument financial assets measured at amortized costs. Loans are non-derivative financial assets with fixed or determinable payments that the Company does not intend to sell immediately or in the near term and that are not quoted in an active market. Loans are initially recognized at fair value and subsequently measured at amortized cost, net of the allowance for credit losses and any unearned income.

Interest income is recognized using the effective interest rate method and is allocated over the expected term of the loan by applying the effective interest rate to the carrying amount of the loan. The effective interest rate is the rate that exactly discounts estimated future cash receipts over the expected life of the loan. Origination revenues and costs are applied to the carrying amount of the loan. Interest income is accrued as earned with the passage of time (see below for the impact of impairment on the accrual of interest under IFRS 9 for 2018 and IAS 39 for periods prior to 2018).



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(unless otherwise stated, all amounts are in Canadian dollars)

### Loans Held for Securitization and Sale

When identifiable, loans for which the Company has the intention of securitizing and derecognizing from the consolidated balance sheets in the near term are carried at fair value and, as indicated above, are classified as financial instruments measured at FVTPL under IFRS 9 for 2018 (classified as held for trading under IAS 39 for periods prior to 2018). Unrealized gains and losses resulting from the change in fair value of these loans are reported as securitization income in non-interest income on the consolidated statements of income. Interest income earned on these loans is included in interest from loans. The fair value of loans held for sale is determined by discounting the expected future cash flows of the loans at market rates for financial instruments with similar terms and credit risk.

### Financial Liabilities

The classification of financial liabilities is largely unchanged under IFRS 9. Deposits, securitization and other liabilities continue to be measured at amortized cost, and derivative liabilities are measured at FVTPL.

### Classification and Measurement of Securities under IAS 39 for Periods Prior to 2018

Securities were classified as either held for trading or available for sale, based on management's intentions. All debt and equity instruments were recognized on the settlement date at their fair value.

Held for trading securities were financial assets purchased for resale, generally within a short period of time and primarily held for liquidity purposes. Interest earned was included in other interest income. Held for trading securities were measured at fair value, using published bid prices, as at the consolidated balance sheet dates. All realized and unrealized gains and losses were reported in income under non-interest income. Transaction costs were expensed as incurred. The Company had not elected under the fair value option to designate any financial asset or liability as held for trading, nor did the Company have any securities classified as held for trading.

Available for sale securities were financial assets purchased for longer-term investment that may be sold in response to or in anticipation of changes in market conditions. Dividends and interest were accrued as earned with the passage of time and were included in dividends from securities or other interest income. Available for sale securities were measured at their fair value, using published bid prices where market value was readily available, as at the consolidated balance sheet dates. Unrealized gains and losses, net of related taxes, were included in AOCI until the security was sold or an impairment loss was recognized, at which time the cumulative gain or loss was transferred to net income. Transaction costs were capitalized.

### Impairment of Financial Instruments – Expected Credit Loss Model

IFRS 9 introduced a new forward-looking three-stage Expected Credit Loss (ECL) model that requires the recognition of an unbiased and probability-weighted impairment amount reflecting a range of possible outcomes. The ECL model applies to all financial assets that are debt instruments classified as amortized cost or FVOCI, and for all loan commitments and financial guarantees not measured at FVTPL. The application of the new ECL model represents a significant change from the incurred loss model under IAS 39, and lifetime credit losses are expected to be recognized earlier. Significant judgements are made in order to incorporate forward-looking information into the estimation of ECL allowances which were not required under IAS 39.

The ECL model consists of the following three stages:

- > Stage 1 includes performing financial assets and is measured using a 12-month ECL, with interest income being recognized on the gross carrying value of the asset.
- > Stage 2 includes financial assets that have experienced a SICR since initial recognition and is measured using a lifetime ECL, with interest income being recognized on the gross carrying value of the asset.
- > Stage 3 includes financial assets that are impaired and is measured using a lifetime ECL, with interest income being recognized on the net carrying value of the asset.

Lifetime ECL is the expected credit losses that result from all possible default events over the expected life of a financial instrument. A 12-month ECL is the portion of lifetime ECL that represents the expected credit losses that result from default events on the financial instrument that are possible within the 12 months following the reporting date. The ECL allowances are calculated through three probability-weighted forward-looking scenarios including base, optimistic, and pessimistic, that measure the expected cash shortfalls on the financial assets related to default events either (i) over the next 12 months or (ii) over the expected life based on the maximum contractual period over which the Company is exposed to credit risk. The expected life of certain revolving credit facilities is based on the period over which the Company is exposed to credit risk and where the credit losses would not be mitigated by management actions.

The three scenarios are updated at each reporting date, and the probability weights and the associated scenarios are determined through a management review process that involves significant judgement and review by the Company's Allowance Committee consisting of representatives from Finance, Enterprise Risk Management and Operations. The Company has engaged an external service provider for forward-looking economic scenarios. The key macroeconomic factors include unemployment rates, housing price index and mortgage rates. In addition, the Allowance Committee exercises expert credit judgements in assessing exposures that have experienced a SICR and in determining the amount of ECL allowances required at each reporting date by considering reasonable



and supportable information that is not already included in the quantitative models. Expert credit judgements are performed by considering emergence of economic, environmental or political events, as well as expected changes to parameters, models or data that are not currently incorporated. Significant judgements made by the Allowance Committee may impact the amount of ECL allowances recognized.

### Measurement of Expected Credit Loss

The Company calculates ECL allowances through the following key inputs over the remaining expected life of the financial asset and discounted to the reporting date at the respective effective interest rate.

- > Probability of Default (PD) measures the estimated likelihood of default over a given time period. PD estimates are updated for each scenario at each reporting date and are based on current and forward-looking information.
- > Loss Given Default (LGD) provides the estimate of loss when default occurs at a given time, and is determined based on historical write-off events, recovery payments, borrower specific attributes and direct costs. The estimate is updated at each reporting date for each scenario based on current and forward-looking information.
- > Exposure At Default (EAD) estimates the exposure at the future default date.

### Significant Increase in Credit Risk

Upon initial recognition of financial assets, the Company recognizes a 12-month ECL allowance which represents the portion of lifetime ECL that result from default events that are possible within the next 12 months (Stage 1). If there has been a SICR, the Company then recognizes a lifetime ECL allowance resulting from possible default events over the expected life of the financial asset (Stage 2). The SICR is determined through changes in the lifetime PD since initial recognition of the financial assets, using a combination of borrower specific and account specific attributes, and relevant reasonable and supportable forward-looking information, with a presumption that credit risk has increased significantly when contractual payments are more than 30 days past due. This assessment considers all reasonable and supportable information about past events, current conditions and forecasts of future events and economic conditions that impact the Company's credit risk assessment. Criteria for assessing SICR are defined at a portfolio level and vary based on the risk of default at the origination of the portfolio. If credit quality subsequently improves such that the increase in credit risk since initial recognition is no longer significant, the loss allowances will revert back to be measured based on a 12-month ECL, and the financial asset will transfer from Stage 2 back to Stage 1. Stages 1 and 2 comprise all non-impaired financial assets.

### Objective Evidence of Impairment

Financial assets with objective evidence of impairment as a result of loss events that have a negative impact on the estimated future cash flows are considered to be impaired, requiring the recognition of lifetime ECL allowances with interest revenue recognized based on the carrying amount of the asset, net of the allowances, rather than its gross carrying amount (Stage 3). Deterioration in credit quality is considered objective evidence of impairment and includes observable data that comes to the attention of the Company, such as significant financial difficulty of the borrower. Under IFRS 9, all financial assets on which repayment of principal or payment of interest is contractually 90 days in arrears are presumed to be impaired. Accordingly, the Company defines default as the earlier of identification of objective evidence of impairment or delinquency of 90 days or more. A financial asset is no longer considered impaired when all past due amounts have been recovered and the objective evidence of impairment is no longer present. In contrast, under IAS 39, impairment was determined based on the number of days payments were in arrears with default considered when payments ranged from 90 to 365 days past due.

### Write-offs

Financial assets are written off, either partially or in full against the related allowances for credit losses when the Company believes there are no reasonable expected future recoveries. Any recoveries of amounts previously written off are credited against provision for credit losses in the consolidated statements of income.

### Loan Modification

The Company defines loan modification as changes to the original contractual terms of the financial asset that represents a fundamental change to the contract or changes that may have a significant impact on the contractual cash flow of the asset. The Company derecognizes the original asset when the modification results in significant change or expiry in the original cash flows; a new asset is recognized based on the new contractual terms. The new asset is initially recognized in Stage 1, and then assessed for SICR on an ongoing basis. If the Company determines the modifications do not result in derecognition, then the asset will retain its original staging and SICR assessments.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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### Impairment of Securities under IAS 39 for Periods Prior to 2018

At the end of each reporting period, the Company conducted a review to assess whether there was any objective evidence that an available for sale security was impaired. Objective evidence of impairment resulted from one or more events that occurred after the initial recognition of the security and which event (or events) had an impact that could be reliably estimated on the estimated future cash flows of the security. A deterioration in credit quality was considered objective evidence of impairment for available for sale debt securities. Such objective evidence included observable data that came to the attention of the Company, such as significant financial difficulty of the issuer of the security, indication that the issuer would enter bankruptcy, or the lack of an active market for a security. A significant or prolonged decline in the fair value of the security below its cost was considered objective evidence of impairment for available for sale equity securities. Management would perform a detailed assessment if there had been a significant decline of 20% or more or a prolonged decline of 12 months or more. Since the business model of the Company is to purchase preferred shares for the purpose of earning dividend income, with the intent of holding them for the long-term, all preferred shares were assessed for impairment using a debt impairment model.

When there was objective evidence of an impairment of an available for sale security, any cumulative loss that had been recognized in OCI was reclassified from AOCI to net income. The amount of the cumulative loss reclassified was the difference between the acquisition cost (net of any principal repayment, amortization and cumulative losses recognized in net income) and current fair value. In the case of debt securities, subsequent increases in fair value that could be objectively related to an event occurring after the impairment loss was recognized resulted in a reversal of the impairment loss through net income. Impairment losses on equity securities were not subsequently reversed through net income.

### Impairment of Loans under IAS 39 for Periods Prior to 2018

A loan was recognized as being impaired (non-performing) when there was objective evidence of deterioration in credit quality to the extent that the Company was no longer reasonably assured of the timely collection of the full amount of principal and interest.

As a matter of practice, an uninsured mortgage, consumer retail loan, Equityline Visa loan or line of credit was deemed to be impaired at the earlier of the date it had been individually provided for or when it had been in arrears for 90 days. Single-family and multi-unit residential mortgages (including securitized mortgages) guaranteed by the Government of Canada were not considered impaired until payment was contractually 365 days past due. Material credit losses are generally not anticipated on insured mortgages. Secured and unsecured credit card balances that had a payment that was contractually 120 days in arrears were individually provided for, and those that had a payment that was 180 days in arrears were written off.

When loans were classified as impaired, the book value of such loans was adjusted to their estimated realizable value based on the fair value of any security underlying the loan, net of any costs of realization, by totally or partially writing off the loan and/or establishing an allowance for loan losses as described below. Interest income continued to accrue when a loan was considered impaired with an appropriate allowance for credit loss, also discussed below.

An impaired loan was not returned to an unimpaired status unless all principal and interest payments were up to date and management was reasonably assured of the recoverability of the loan.

An allowance for credit losses was maintained at an amount that, in management's opinion, was considered adequate to absorb all credit-related losses that had occurred in the portfolio whether or not detected at the period end, including accrued interest on impaired loans. Allowances were mainly related to loans but could also apply to other assets. The allowance consisted of accumulated individual and collective allowances, each of which was reviewed at least quarterly. The collective allowance was deducted from total loans on the consolidated balance sheets. The allowance was increased by the provision for credit losses and decreased by write-offs, net of recoveries.

Individual allowances were determined on an item-by-item basis and reflected the associated estimate of credit loss. The individual allowances were the amounts required to reduce the carrying value of an impaired asset, including accrued interest, to its estimated realizable amount. The fair value of any underlying security was used to estimate the realizable amount of the receivable. The allowance was the difference between the receivable's carrying value, including accrued interest, and its estimated realizable amount.

Collective allowances were established to absorb credit losses on the aggregate exposures in each of the Company's loan portfolios for which losses had been incurred but not yet individually identified. The collective allowance took into account asset quality, borrower creditworthiness, property location, past loss experience, probability of default and exposure at default based on product, risk ratings, credit scores, current economic conditions, and management's judgement. The collective allowance, based on the historical loss experience adjusted to reflect changes in the portfolios and credit policies, was applied to each pool of loans with common risk characteristics. This estimate included consideration of economic and business conditions.

## Obligations Related to Securities Sold under Repurchase Agreements

The purchase and sale of securities under sale and repurchase agreements are accounted for as collateralized lending and borrowing transactions and are recorded at cost. The related interest income and interest expense are recorded on an accrual basis in the consolidated statements of income.

## Derecognition of Financial Assets

The Company derecognizes a financial asset when the contractual rights to that asset have expired. If substantially all the risks and rewards of ownership of the financial asset have been retained, the Company continues to recognize the financial asset and also recognizes a financial liability for the consideration received. If substantially all the risks and rewards of ownership of the financial asset have been transferred, the Company will derecognize the financial asset and recognize separately as assets or liabilities any rights or obligations created or retained in the transfer.

The Company periodically pools and securitizes insured mortgages under Canada Mortgage and Housing Corporation's (CMHC) National Housing Act (NHA) Mortgage-Backed Securities (MBS) program and sells the securities to investors or uses the securities as collateral for participation in CMHC's Canada Mortgage Bond (CMB) program. Mortgage loan securitization activities are a part of the Company's funding and liquidity strategies.

Most transfers of pools of mortgages under the MBS and CMB programs do not result in derecognition of the mortgages from the Company's consolidated balance sheets because the Company continues to hold a residual interest. As such, these transactions result in the recognition of securitization liabilities when cash is received and the mortgages are reclassified to securitized residential mortgages on the consolidated balance sheets and continue to be accounted for as loans.

Securitization liabilities are recorded at amortized cost using the effective interest rate method. Interest expense is allocated over the expected term of the borrowing by applying the effective interest rate to the carrying amount of the liability. The effective interest rate is the rate that exactly discounts estimated future cash outflows over the expected life of the liability. Transaction costs and premiums or discounts are applied to the carrying amount of the liability. Also included in securitization liabilities on the consolidated balance sheets are amounts related to fair value hedge accounting that increase or decrease the carrying amount of the securitization liability. Please see Note 18 for more information.

In certain cases, the Company's remaining involvement is quite limited, although it has not transferred substantially all of the risks and rewards in the underlying loans and it has retained control, as defined by IFRS 9. Such mortgages are securitized and sold, and the Company has a retained interest and servicing responsibilities for the assets sold, with very little exposure to variable cash flows. The Company accounts for its continuing involvement as retained interests and servicing liabilities on the consolidated balance sheets. Gains or losses on these transactions are recognized as securitization income in non-interest income on the consolidated statements of income and are dependent in part on the previous carrying amount of the financial assets involved in the transfer, allocated between the assets sold and the retained interests, based on their relative fair value at the date of transfer and net of transaction costs. Retained interests are carried at fair value and classified as debt instrument financial assets measured at FVOCI (classified as available for sale assets under IAS 39 for periods prior to 2018). The fair value of the retained interests is estimated using discounted cash flow methodology. Retained interests are revalued quarterly to assess for impairment.

The Company may sell its residual interest arising from securitization transactions, resulting in the transfer of substantially all of the risks and rewards of ownership associated with the underlying mortgages. The mortgages are derecognized and a resulting gain or loss is recognized as securitization income in non-interest income on the consolidated statements of income.

The Company previously transferred cash flows from residential mortgages as part of a bank-sponsored securitization conduit program to receive access to cost-effective funding. Mortgages continue to be recognized on the consolidated balance sheets, along with a securitization liability, as the risks and rewards of ownership of mortgages have not been transferred.

## Restricted Assets

Restricted assets include cash or cash equivalents and securities that are contractually restricted, such as collateral associated with derivative transactions and participation in securitization programs. Restricted assets also include acceptable securities pledged as CMB replacement assets. The accounting treatment for cash and securities is described above. Mortgages assigned as collateral in the Company's securitization programs or as collateral for the Company's credit facilities are included in loans on the consolidated balance sheets. Please see Notes 4(A), 6(A) and 7 for more information.

## Derivatives Held for Risk Management Purposes

The Company utilizes derivatives to manage interest rate risk and equity price risk. Derivatives are recognized on the trade date and carried at fair value. Derivatives are reported as assets if they have a positive fair value and as liabilities if they have a negative fair value. The Company uses bond forwards to economically hedge interest rate risk on loans held for sale that are not designated in hedge accounting relationships. The realized and unrealized gains or losses on the bond forwards are recognized in non-interest income on the consolidated statements of income.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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### Hedge Accounting

As indicated above and as permitted, the Company elected to continue to apply hedge accounting to derivatives that meet the criteria for hedge accounting in accordance with IAS 39. The Company utilizes two types of hedge relationships for accounting purposes, fair value hedges and cash flow hedges. If derivative instruments do not meet all of the criteria for hedge accounting, the changes in fair value of such derivatives are recognized in non-interest income.

In order to qualify for hedge accounting, a hedge relationship must be designated and formally documented in accordance with IAS 39. The Company's documentation, in accordance with the requirements, includes the specific risk management objective and strategy being applied, the specific financial asset or liability or cash flow being hedged and how hedge effectiveness is assessed. To qualify for hedge accounting, there must be a correlation of between 80% and 125% in the changes in fair values or cash flows between the hedged and hedging items.

Hedge effectiveness is assessed at the inception of the hedging relationship and on an ongoing basis. Hedge ineffectiveness occurs when the changes in the fair value of the hedging item (derivative) differ from the fair value changes in the hedged risk in the hedged item. Hedge ineffectiveness is recognized immediately in non-interest income.

### Fair Value Hedges

The Company's fair value hedges generally use interest rate swaps to hedge changes in the fair value of fixed-rate assets or liabilities (the hedged items) attributable to interest rate risk. Changes in the fair value of the hedged items are recorded as part of the carrying value of the hedged items and are recognized in net realized and unrealized gain or loss on derivatives. Changes in the fair value of the hedging item (interest rate swap) are also recognized in net realized and unrealized gain or loss on derivatives.

If the hedging instrument expires, or is settled or sold, or if the hedge no longer meets the criteria for hedge accounting under IAS 39, the hedge relationship is terminated and the fair value adjustment on the hedged item is then amortized over the remaining term of the hedged item. If the hedged item is settled, the unamortized fair value adjustment is recognized in non-interest income immediately.

### Cash Flow Hedges

The Company's cash flow hedges use bond forwards or interest rate swaps to hedge changes in future cash flows attributable to interest rate fluctuations arising on highly probable forecasted issuances of fixed-rate liabilities. Total return swaps are used to hedge the variability in cash flows associated with forecasted future compensation obligations attributable to changes in the Company's stock price.

The effective portion of the change in fair value of the derivative instrument is recognized in OCI until the forecasted cash flows being hedged are recognized in income in future accounting periods. When the forecasted cash flows are recognized in income, an appropriate amount of the fair value changes of the derivative instrument is reclassified from AOCI into income. Any hedge ineffectiveness is immediately recognized in non-interest income. If the forecasted transaction is no longer expected to occur, the related cumulative gain or loss in AOCI is immediately recognized in non-interest income.

If the hedging instrument expires, or is settled or sold, or if the hedge no longer meets the criteria for hedge accounting under IAS 39, the hedge relationship is terminated. Any cumulative gain or loss recognized at that time remains in AOCI until the forecasted transaction impacts the consolidated statements of income. When the forecasted transaction is no longer expected to occur, the cumulative gain or loss that was recognized in AOCI is immediately recognized in non-interest income.

### Capital Assets

Capital assets, which comprise office furniture and equipment, computer equipment and purchased software, and leasehold improvements, are recorded at cost and amortized over their estimated useful lives on a straight-line basis. The ranges of useful lives for each asset type are as follows:

Office furniture and equipment	3 to 10 years
Computer equipment and purchased software	3 to 7 years
Leasehold improvements are amortized on a straight-line basis over the remaining term of the lease.	

The Company assesses, at each reporting period date, whether there is an indication that a capital asset may be impaired. If any indication of impairment exists, the Company performs an impairment test to determine whether an impairment loss is required to be recognized. The impairment tests are performed in accordance with the steps discussed in the accounting policy note below entitled Impairment of Capital Assets and Intangible Assets.

## Intangible Assets

The Company's intangible assets comprise internally developed software costs. An intangible asset is recognized only when its cost can be measured reliably and it is probable that the expected future economic benefits that are attributable to the asset will flow to the Company. In addition, the Company capitalizes borrowing costs directly attributable to the intangible assets flowing to the Company by applying a capitalization rate to the expenditures on the intangible assets. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and any accumulated impairment losses.

All of the Company's intangible assets are considered to have finite useful lives and are amortized on a straight-line basis over their useful lives. The amortization period and the amortization method are reviewed at least at each financial year end. Changes in the expected useful lives are accounted for by changing the amortization period, as appropriate, and are treated as changes in accounting estimates. Amortization expense is included in other operating expenses in the consolidated statements of income.

The Company capitalizes eligible development costs related to software projects. Eligible costs include external direct costs for materials and services, as well as payroll and payroll-related costs for employees directly associated with development. The Company commences amortization of these costs over the appropriate useful life when development of the asset is substantially complete and the asset becomes available for use in the manner intended by management. Overhead costs, costs incurred during the research phase, costs to train staff to operate the asset and costs incurred after the software was substantially completed and available for use are expensed as incurred.

The Company assesses, at each reporting period date, whether there is an indication that an intangible asset may be impaired. If any indication of impairment exists, the Company performs an impairment test to determine whether an impairment loss is required to be recognized. In relation to development costs for software that is not yet available for use, the Company performs an impairment test on an annual basis as well as when indications of impairment exist. Such annual impairment tests will continue until the software is available for use. The impairment tests are performed in accordance with the steps discussed in the accounting policy note below entitled Impairment of Capital Assets and Intangible Assets.

## Goodwill

Goodwill is initially measured as the excess of the price paid for the acquisition of a consolidated entity over the fair value of the net identifiable tangible and intangible assets acquired. Goodwill is allocated to the cash-generating units (CGUs) or groups of CGUs that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units. A CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. Each unit to which the goodwill has been allocated represents the lowest level within the Company at which the goodwill is monitored for internal management purposes.

Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is evaluated for impairment annually or more often if events or circumstances indicate there may be impairment. Impairment is determined for goodwill by assessing whether the carrying amount of a CGU, including the allocated goodwill, exceeds its recoverable amount. The recoverable amount is determined as the greater of the estimated fair value less the costs of disposal or the value in use. Impairment losses recognized in respect of a CGU are first allocated to the carrying amount of goodwill and any excess is allocated pro rata to the carrying amount of other assets in the CGU, on the basis of the carrying amount of each asset in the unit. Goodwill impairment is recorded as non-interest expense in the period in which the impairment is identified. Impairment losses on goodwill are not subsequently reversed.

## Impairment of Capital Assets and Intangible Assets

The Company assesses at each reporting date whether there is an indication that an asset may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Company estimates the asset's recoverable amount. If it is not possible to determine the recoverable amount of the individual asset, the Company determines the recoverable amount of the CGU to which the asset belongs. The recoverable amount of an asset or a CGU is the higher of its fair value, less costs of disposal, and its value in use, where value in use is the present value of the future cash flows expected to be derived from the asset or the CGU. Where the carrying amount of the asset or the CGU exceeds its recoverable amount, the asset is considered impaired and written down to its recoverable amount. The Company evaluates impairment losses for potential reversals when events or changes in circumstances warrant such consideration.

## Deposits

Deposits are financial liabilities that are measured at amortized cost using the effective interest rate method. Deposit origination costs are included in deposits on the consolidated balance sheets as incurred and amortized to interest expense over the term of the deposit. Also included in deposits on the consolidated balance sheets are amounts related to fair value hedge accounting that increase or decrease the carrying amount of deposits. Please see Note 18 for more information.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(unless otherwise stated, all amounts are in Canadian dollars)

### Income Taxes

Income tax comprises current and deferred tax and is recognized in net income, except to the extent that it relates to items recognized directly in shareholders' equity, in which case the related taxes are also recognized directly in shareholders' equity. The Company follows the asset and liability method of accounting for income taxes, whereby deferred tax assets and liabilities are recognized for the expected future tax consequences attributable to temporary differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted or substantively enacted tax rates applicable to taxable income in the period in which those temporary differences are expected to be recovered or settled. Deferred tax assets are only recognized for deductible temporary differences, carry forward of unused tax credits and losses to the extent that it is probable that taxable profit will be available and the carry forward of unused tax credits and losses can be utilized.

### Fair Value

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is determined using the principal market or most advantageous market that is accessible to the Company for the asset or liability.

Valuation techniques used to determine fair value maximize the use of relevant observable inputs and minimize the use of unobservable inputs. If the asset or liability measured at fair value has a bid price and an ask price, the price within the bid-ask spread that is most representative of fair value in the circumstances is used to measure the fair value. Please see Note 20 for more information on the specific valuation techniques used to determine fair value and the related inputs for each class of assets or liabilities where fair value is disclosed.

Inputs for valuation techniques used to measure fair value are categorized into three levels. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that are accessible at the measurement date. Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Level 3 inputs are unobservable inputs for the asset or liability. Please see Note 20 for more information. When inputs used to measure the fair value of an asset or liability are categorized within different levels of the fair value hierarchy, the fair value measurement is categorized in its entirety in the same level of the fair value hierarchy as the lowest level input that is significant to the entire measurement.

### Fees and Other Income

Fee income primarily relates to payment services and loan servicing and administration, net of related expenses to service the loans, with the net revenue recognized as the associated services are rendered.

### Stock-based Compensation Plans

The Company has stock-based compensation plans, which are described in Note 14.

The Company's Employee Stock Option Plan provides for the granting of stock options to certain employees of the Company. In some cases, stock appreciation rights are also granted in tandem with the stock option, providing the Company with, at its sole discretion, the alternative of settling the award in cash at an amount equal to the excess of the market price of the shares to which the option relates over the exercise price of the option. The Company accounts for stock options, including those with tandem stock appreciation rights, as equity-settled transactions where the fair value of options granted is recognized as salary expense over the option vesting period, with the offsetting amount recognized in contributed surplus. For awards with graded vesting, the fair value of each tranche is recognized separately over its respective vesting period. For each reporting period, the Company reassesses its estimates of the number of awards that are expected to vest and recognizes the impact of any revision in the consolidated statements of income, with a corresponding adjustment to equity. The Company has historically determined the fair value of the options granted using the Black-Scholes option pricing model. Commencing with options granted in September 2017, the Company uses the binomial option pricing model as it more accurately reflects the impact of the volatility and dividend assumptions in the valuation of the options granted. The change in the valuation methodology has been applied prospectively.

The Company offers a deferred share unit (DSU) plan that is only open to non-employee Directors of the Company who annually elect to accept remuneration in the form of cash and DSUs or only DSUs. The Company accounts for the DSUs as cash-settled transactions. Under the plan, the obligations for the DSUs are accrued quarterly based on the Directors' remuneration for the quarter. Each reporting period, the obligations are adjusted for fluctuations in the market price of the Company's common shares and allow for dividend equivalents. Changes in obligations under the plan are recorded as salaries and benefits expense in the consolidated statements of income, with a corresponding increase in other liabilities on the consolidated balance sheets.

The Company grants restricted share units (RSUs) and performance share units (PSUs) to certain key members of management, which are settled in cash equivalents of common shares and earn dividend equivalents at the same rate as dividends on common shares. Salaries and benefits expense is recognized based on the fair value of the share units at the grant date adjusted for changes in fair value between the grant date and the vesting date, net of the effects of hedges, over the service period required for employees to become fully entitled to the awards. Changes in the PSU obligation resulting from changes in the market price of common shares are multiplied by a performance factor ranging from 50% to 150% and are recognized in the consolidated statements of income as salaries and benefits expense.



## Employee Benefit Plans

Under both the Employee Share Purchase Plan and the Employee Retirement Savings Plan, the Company's contribution is expensed when paid. Please see Note 14 for more information.

## Earnings per Share

Both basic and diluted earnings per share (EPS) are presented for the Company's common shares. Basic earnings per common share is determined as net income for the year divided by the average number of common shares outstanding for the year.

Diluted earnings per common share is determined as net income for the year divided by the average number of common shares outstanding plus the stock options potentially exercisable for the year, as determined under the treasury stock method. The treasury stock method determines the net number of incremental common shares that could be purchased with the assumption that all in-the-money stock options are exercised and the proceeds are used to purchase common shares at the average market price during the year.

## Acquisitions

The consideration transferred related to an acquisition is measured at the fair value of the consideration transferred, which would include the fair value of any contingent consideration. Direct transaction costs of acquisitions are recognized as an expense in the period in which they are incurred. Identifiable assets and liabilities acquired are measured at their fair value and recognized on the Company's consolidated balance sheets. Goodwill is measured as the excess of the consideration transferred over the net of the fair value amounts of identifiable assets acquired and liabilities assumed. To the extent the net fair value of the purchased assets and assumed liabilities exceeds the consideration transferred, the excess is recognized as a gain on acquisition in the consolidated statements of income. The results of operations of acquired businesses are included in the Company's consolidated financial statements beginning on the date of acquisition.

# 3. Current and Future Changes in Accounting Policies

## Current Period Changes in Accounting Policies

### IFRS 9 *Financial Instruments*

On January 1, 2018, the Company adopted IFRS 9 *Financial Instruments* (IFRS 9), which replaces IAS 39 *Financial Instruments: Recognition and Measurement* (IAS 39). IFRS 9 includes requirements for classification and measurement of financial assets and liabilities, impairment of financial assets and general hedge accounting. Please see Note 2 for a description of the accounting policies for financial instruments under IFRS 9 along with information on the comparison of IFRS 9 and IAS 39 where relevant.

IFRS 9 is effective for annual periods beginning on or after January 1, 2018 and is to be applied retrospectively with certain exceptions. The Company, as permitted, did not restate comparative period financial information. Amendments were also made to IFRS 7 *Financial Instruments: Disclosures* (IFRS 7) introducing expanded qualitative and quantitative disclosures related to IFRS 9, which the Company has also adopted for the annual period beginning January 1, 2018.

An adjustment to opening retained earnings and AOCI was not required on adoption of IFRS 9 on January 1, 2018 as there were no measurement differences as a result of changes in classification of financial instruments and no measurement differences in the overall allowance for credit losses. There were also no measurement differences within AOCI on transition. However, there were changes to how the allowance for credit losses are allocated to each of the Company's underlying loan portfolios.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(unless otherwise stated, all amounts are in Canadian dollars)

Please see the table below for the reconciliation of allowance for credit losses from IAS 39 to IFRS 9 for more information.

thousands of Canadian dollars	Single-family Residential Mortgages	Commercial Mortgages	Credit Card Loans and Lines of Credit	Other Consumer Retail Loans	Total
Allowance for credit losses on principal at December 31, 2017 under IAS 39	\$ 22,069	\$ 9,077	\$ 3,553	\$ 4,076	\$ 38,775
Allowance for credit losses on accrued interest receivable at December 31, 2017 under IAS 39	1,016	478	—	7	1,501
Total allowance for credit losses at December 31, 2017 under IAS 39	23,085	9,555	3,553	4,083	40,276
Collective allowance under IAS 39	(20,340)	(6,327)	(3,096)	(3,800)	(33,563)
Stage 1 allowance under IFRS 9	11,610	3,898	823	565	16,896
Stage 2 allowance under IFRS 9	7,280	3,318	1,965	2,199	14,762
Individual allowances on principal and accrued interest receivable under IAS 39	(2,745)	(3,228)	(457)	(283)	(6,713)
Stage 3 allowance under IFRS 9	3,563	3,300	1,196	559	8,618
Net remeasurements upon adoption of IFRS 9	(632)	961	431	(760)	—
Allowance for credit losses as at January 1, 2018 under IFRS 9	\$ 22,453	\$ 10,516	\$ 3,984	\$ 3,323	\$ 40,276

IFRS 9 also introduced a new general hedge accounting model that aims to better align accounting with risk management activities. The Company had an accounting policy choice to adopt the new general hedge accounting model under IFRS 9 or continue to apply the hedge accounting requirements under IAS 39. As permitted, the Company elected to continue to apply the hedge accounting requirements under IAS 39. The Company has implemented the revised annual hedge accounting disclosures that are required under IFRS 7 in these consolidated financial statements.

### IFRS 15 Revenue from Contracts with Customers

On January 1, 2018, the Company adopted IFRS 15 *Revenue from Contracts with Customers* (IFRS 15). IFRS 15 supersedes IAS 11 *Construction Contracts*, IAS 18 *Revenue* and related interpretations and it applies to all revenue arising from contracts with customers. IFRS 15 establishes the principles for recognizing revenue and cash flows arising from contracts with customers and prescribes the application of a five-step recognition and measurement model. IFRS 15 does not apply to financial instruments and other contractual rights and obligations under the scope of IFRS 9 and did not have a financial impact on the Company upon transition.

### Amendments to IFRS 2 Share-based Payment

On January 1, 2018, the Company adopted the narrow scope amendments to IFRS 2 *Share-based Payment* related to the classification and measurement of share-based payment transactions and has applied the standard prospectively. The amendment clarified the accounting for cash-settled share-based payment transactions that include a performance condition, the classification of share-based payment transactions with net settlement features for withholding tax obligations, and the accounting for modifications of share-based payment transactions from cash-settled to equity settled. There was no impact on the consolidated financial statements as a result of the adoption of the new amendments.

### Future Changes in Accounting Policies

The following accounting pronouncements issued by the IASB were not effective as at December 31, 2018 and therefore have not been applied in preparing these consolidated financial statements.

### Amendments to IFRS 9 Financial Instruments

In October 2017, the IASB published amendments to IFRS 9 relating to prepayment features with negative compensation. The amendments are to be applied retrospectively to annual reporting periods beginning on or after January 1, 2019 with earlier applications permitted. Based on preliminary assessments, the amendments are not expected to materially impact the Company's consolidated financial statements.



## IFRS 16 Leases

In January 2016, the IASB issued IFRS 16 *Leases* (IFRS 16) which sets out the principles for the recognition, measurement, presentation and disclosure of leases. The standard removes the current requirements under IAS 17 *Leases* (IAS 17) and related interpretations for lessees to classify leases as finance leases or operating leases by introducing a single lessee accounting model that requires the recognition of lease assets and lease liabilities on the balance sheet for most leases. Lessees will also recognize depreciation expense on the right-of-use asset, interest expense on the lease liability, and shift the timing of expense recognition in the consolidated statements of income. There are no significant changes to lessor accounting aside from enhanced disclosure requirements. IFRS 16 is effective for the Company on January 1, 2019. The Company plans to adopt IFRS 16 using the modified retrospective approach by adjusting the consolidated balance sheet at January 1, 2019, the date of initial application, with no restatement of comparative periods. The Company will elect to apply practical expedients allowing the use of a single discount rate to a portfolio of leases with similar characteristics; the exclusion of initial direct costs from the measurement of the right-of-use asset at the date of initial application; the exclusion of short-term leases, which are defined as those that have a lease term of 12 months or less; and the exclusion of leases for low-value items.

The Company has completed the process of assessing existing contractual relationships to identify leases that would be recorded on the consolidated balance sheets under IFRS 16. The Company continues to evaluate the potential impact to the existing systems and processes, and the additional disclosures required by the new standard. Initial quantification indicates that the Company's lease liability will be in the range of \$28 million to \$32 million exceeding the right-of-use asset which will be in the range of \$25 million to \$28 million. This excess of the liabilities over the assets will result in a reduction in retained earnings in the range of \$3 million to \$4 million upon adoption of IFRS 16 on January 1, 2019.

## 4. Cash Resources, Credit Facilities and Securities

### (A) Cash Resources and Credit Facilities

thousands of Canadian dollars	December 31 2018	December 31 2017
Cash and cash equivalents	\$ 665,947	\$ 1,336,138

### Committed Secured Standby Credit Facility

Home Trust has a \$500 million secured committed standby credit facility with a syndicate of Canadian chartered banks (the "lenders"), which was undrawn as at December 31, 2018. Should an amount be drawn, the transaction would be accounted for as secured financing in the consolidated financial statements of the Company. As required under the terms of the facility, Home Trust created a bankruptcy remote special purpose entity (SPE), which is a consolidated entity of Home Trust. The facility is limited to \$500 million and is subject to Home Trust transferring eligible collateral to the SPE. To preserve the available credit amount, Home Trust would need to replace assets that no longer meet the eligibility requirements. Under the terms of the facility, the lenders cannot require the transfer of eligible assets from the SPE back to Home Trust. As at December 31, 2018, the facility is secured against a portfolio of eligible mortgages with a carrying value totalling \$598.8 million, which were legally transferred from Home Trust to the SPE along with the related security. The Company and Home Trust do not guarantee any debt obligations of the SPE and the lenders have recourse only to the assets of the SPE and not to the general assets of Home Trust or the Company. The Company also provides a performance guarantee of Home Trust's obligations required under the facility.

Under the terms of the facility, Home Trust paid a non-refundable upfront commitment fee of \$3.75 million. The interest rate on any drawn portion is equal to 3-month CDOR plus 150 basis points, subject to certain terms. The annual standby fee on undrawn funds is 0.60%. The facility matures on June 29, 2020, and any advances that are outstanding on that date fully mature on June 29, 2022. Funds drawn on the facility are repayable at any time. Amortization of the upfront commitment fee, the standby fee and interest expense on any drawn amounts are included in interest and fees on line of credit facilities in the consolidated statements of income. Transaction costs on the facility are amortized over the life of the facility and are also included in interest and fees on line of credit facilities.

The Company had a \$2 billion line of credit facility with a wholly owned subsidiary of Berkshire Hathaway Inc., a major US investment firm. The facility matured at the end of June 2018 and there were no amounts outstanding at that time. Interest expense on drawn amounts and the standby fee on drawn amounts are included in interest and fees on line of credit facilities in the consolidated statements of income. Transaction costs on the facility were amortized over the life of the facility and are also included in interest and fees on line of credit facilities.

The initial draw on the \$2 billion line of credit facility referred to above was used to repay and terminate an emergency credit facility that was obtained during the liquidity event experienced in the second quarter of 2017. Under the terms of the emergency credit facility, the Company paid a non-refundable commitment fee of \$100.0 million, interest at a rate of 10% on outstanding balances and a standby fee of 2.5% on undrawn balances. All interest on drawn amounts, the full \$100.0 million commitment fee and other transaction costs associated with the emergency credit facility was included in interest and fees on line of credit facilities in the consolidated statements of income.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(unless otherwise stated, all amounts are in Canadian dollars)

### Secured Warehouse Credit Facility

Home Trust has a \$300 million secured warehouse credit facility with a syndicate of Canadian chartered banks. The balance at December 31, 2018 included in credit facilities on the consolidated balance sheets was \$261.5 million. As at December 31, 2018, the facility is secured against insured mortgages with a carrying value totalling \$269.7 million. The interest rate on any drawn amount is variable. Any undrawn amounts are subject to a fixed-rate commitment fee. The facility expires on October 31, 2019, and amounts drawn on the facility are payable within 180 days from the date of draw.

Interest expense is included in interest and fees on line of credit facilities in the consolidated statements of income. Transaction costs on the facility are amortized over the life of the facility and are also included in interest and fees on line of credit facilities.

### Uncommitted Secured Credit Facility

The Company also has an uncommitted secured credit facility with a Canadian chartered bank in the amount of \$20 million, subject to letters of credit issued against the facility. As at December 31, 2018, the facility is undrawn.

### (B) Securities at Fair Value by Type and Remaining Term to Maturity and Rate Reset Date

The following table presents the Company's securities at fair value by type and remaining term to maturity or rate reset date. Debt securities presented in the following table are classified as debt securities measured at FVOCI under IFRS 9 for 2018. Preferred shares are classified as equity securities designated at FVOCI under IFRS 9 for 2018. Both debt securities and preferred shares were classified as available for sale under IAS 39 in 2017.

thousands of Canadian dollars						December 31	December 31
						2018	2017
	Within 1 Year	1 to 3 Years	3 to 5 Years	Over 5 Years	Total Fair Value	Total Fair Value	Total Fair Value
Debt securities	\$ —	\$ 50,440	\$ 309,541	\$ —	\$ 359,981	\$ 301,534	
Preferred shares	4,905	17,317	4,130	—	26,352	30,934	
	\$ 4,905	\$ 67,757	\$ 313,671	\$ —	\$ 386,333	\$ 332,468	

### (C) Securities – Net Unrealized Gains and Losses

thousands of Canadian dollars, except %						As at December 31, 2018	
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Total Fair Value	Weighted-Average Yield		
Debt securities measured at FVOCI	\$ 359,753	\$ 228	\$ —	\$ 359,981	2.4%		
Preferred shares designated at FVOCI	40,340	—	(13,988)	26,352	3.4%		
	\$ 400,093	\$ 228	\$ (13,988)	\$ 386,333			

thousands of Canadian dollars, except %						As at December 31, 2017	
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Total Fair Value	Weighted-Average Yield		
Debt securities available for sale	\$ 300,037	\$ 1,497	\$ —	\$ 301,534	1.7%		
Preferred shares available for sale	40,339	—	(9,405)	30,934	2.7%		
	\$ 340,376	\$ 1,497	\$ (9,405)	\$ 332,468			

The unrealized gains or losses included above represent the differences between the cost of a security and its current fair value.

Included in securities are preferred shares with a carrying amount of \$24.1 million and government bonds with a carrying amount of \$10.1 million which are held as security for the \$20 million uncommitted secured credit facility referred to in Note 4(A) above. The Company may at any time and at its discretion replace the preferred shares and government bonds as security for the credit facility with other acceptable forms of security.

During the year, the Company sold government bonds for proceeds of \$412.4 million (2017 – \$338.1 million) and recognized gains of \$1.0 million (2017 – \$1.0 million). There were no sales of preferred shares in 2018. In 2017, the Company sold preferred shares for proceeds of \$154.2 million resulting in the realization of losses of \$72.9 million.

### Debt Securities Measured at FVOCI

Net unrealized gains and losses (excluding impairment losses, which are recognized in the consolidated statements of income) are included in AOCI and presented in the table above. These unrealized gains and losses are not included in net income. Please see Note 15 for more information.

As of December 31, 2018, there were no allowances for credit losses recognized on debt securities. All debt securities held are Government of Canada debt securities and are classified as Stage 1.

Interest income earned on debt securities measured at FVOCI was \$6.0 million for the year and is included in other interest in the consolidated statements of income.

### Equity Securities Designated at FVOCI

Equity securities designated at FVOCI include non-trading equity securities and, for the Company, consist entirely of preferred shares. Net unrealized gains and losses are included in AOCI and presented in the table above. These unrealized gains and losses are not included in net income. Please see Note 15 for more information.

All dividend income was earned on equity securities designated at FVOCI still held at the end of the reporting period.

## 5. Loans

### (A) Loans by Product<sup>1</sup>

thousands of Canadian dollars

As at December 31, 2018

	Gross Carrying Amount	Allowance for Credit Losses	Net Carrying Amount
Securitized single-family residential mortgages <sup>2</sup>	\$ 2,489,971	\$ 271	\$ 2,489,700
Securitized multi-unit residential mortgages	310,652	421	310,231
Total securitized mortgages	2,800,623	692	2,799,931
Single-family residential mortgages	11,068,588	25,788	11,042,800
Commercial mortgages <sup>3</sup>	1,671,101	16,353	1,654,748
Credit card loans and lines of credit	405,051	3,703	401,348
Other consumer retail loans	319,024	5,155	313,869
Total non-securitized mortgages and loans <sup>4</sup>	13,463,764	50,999	13,412,765
	\$16,264,387	\$ 51,691	\$16,212,696

<sup>1</sup> The balances as at December 31, 2018 have been prepared in accordance with IFRS 9.

<sup>2</sup> Securitized single-family residential mortgages include both CMHC-sponsored securitized insured mortgages and bank-sponsored securitization conduit uninsured mortgages.

<sup>3</sup> Commercial mortgages include both non-residential commercial mortgages and residential commercial mortgages. Residential commercial mortgages include non-securitized multi-unit residential mortgages and commercial mortgages secured by residential property types.

<sup>4</sup> Loans exclude mortgages held for sale.

### (B) Loans by Geographic Region and Type (Gross of Allowance for Credit Losses)

thousands of Canadian dollars, except %

As at December 31, 2018

	British Columbia	Alberta	Ontario	Quebec	Other	Total
Securitized single-family residential mortgages <sup>1</sup>	\$ 207,915	\$ 406,894	\$ 1,517,977	\$ 93,869	\$ 263,316	\$ 2,489,971
Securitized multi-unit residential mortgages	65,326	14,723	159,923	18,399	52,281	310,652
Total securitized mortgages	273,241	421,617	1,677,900	112,268	315,597	2,800,623
Single-family residential mortgages	843,931	381,115	9,241,649	293,473	308,420	11,068,588
Residential commercial mortgages <sup>2</sup>	43,688	7,307	158,799	6,653	2,948	219,395
Non-residential commercial mortgages	98,889	45,751	1,266,194	35,692	5,180	1,451,706
Credit card loans and lines of credit	13,475	16,932	366,214	1,836	6,594	405,051
Other consumer retail loans	1,600	10,688	288,556	132	18,048	319,024
Total non-securitized mortgages and loans <sup>3</sup>	1,001,583	461,793	11,321,412	337,786	341,190	13,463,764
	\$ 1,274,824	\$ 883,410	\$12,999,312	\$ 450,054	\$ 656,787	\$16,264,387
As a % of portfolio	7.8%	5.4%	80.0%	2.8%	4.0%	100.0%

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(unless otherwise stated, all amounts are in Canadian dollars)

### (B) Loans by Geographic Region and Type (Gross of Allowance for Credit Losses) (Continued)

thousands of Canadian dollars, except %

As at December 31, 2017

	British Columbia	Alberta	Ontario	Quebec	Other	Total
Securitized single-family residential mortgages <sup>1</sup>	\$ 228,024	\$ 278,110	\$ 1,666,337	\$ 84,977	\$ 177,760	\$ 2,435,208
Securitized multi-unit residential mortgages	84,860	44,728	227,686	45,664	155,104	558,042
Total securitized mortgages	312,884	322,838	1,894,023	130,641	332,864	2,993,250
Single-family residential mortgages	525,998	366,665	8,688,139	251,529	204,920	10,037,251
Residential commercial mortgages <sup>2</sup>	9,819	1,924	96,817	3,037	2,760	114,357
Non-residential commercial mortgages	18,853	10,888	989,223	24,190	2,449	1,045,603
Credit card loans and lines of credit	6,221	17,263	321,390	1,515	5,673	352,062
Other consumer retail loans	1,950	11,543	330,323	198	17,152	361,166
Total non-securitized mortgages and loans <sup>3</sup>	562,841	408,283	10,425,892	280,469	232,954	11,910,439
	\$ 875,725	\$ 731,121	\$ 12,319,915	\$ 411,110	\$ 565,818	\$ 14,903,689
As a % of portfolio	5.9%	4.9%	82.6%	2.8%	3.8%	100.0%

<sup>1</sup> Securitized single-family residential mortgages include both CMHC-sponsored securitized insured mortgages and bank-sponsored securitization conduit uninsured mortgages.

<sup>2</sup> Residential commercial mortgages include non-securitized multi-unit residential mortgages and commercial mortgages secured by residential property types.

<sup>3</sup> Loans exclude mortgages held for sale.

### (C) Allowance for Credit Losses

The allowance for credit losses under IFRS 9 requires the consideration of forward-looking information. Forward-looking information is incorporated in both the determination of whether there has been a significant increase in credit risk (SICR) since initial recognition of the financial asset and in the measurement of ECL allowances.

The Company has determined that the following forward-looking macroeconomic factors are the key drivers that contribute to credit losses: unemployment rates, housing price index and interest rates. These macroeconomic factors are forecasted at the provincial and national level.

The ECL allowances are calculated through three probability-weighted forward-looking scenarios including base, optimistic, and pessimistic, which are chosen from a number of scenarios provided by an external service provider engaged by the Company to provide this forward-looking macroeconomic information. The three scenarios are reviewed and updated, as necessary at each reporting date, and the probability weights and the associated scenarios are determined through a management review process that involves significant judgement and review by the Company's Allowance Committee consisting of representatives from Finance, Enterprise Risk Management and Operations.

The following table provides the values of the forward-looking macroeconomic inputs at the national level over the next twelve months for each of the scenarios.

	Base	Optimistic	Pessimistic
Average unemployment rate	6.04%	5.37%	7.30%
Housing price index (annual change)	2.47%	5.01%	(4.15)%
Average mortgage one-year rate	4.55%	4.73%	3.23%

The allowance for credit losses is sensitive to the inputs used in models, including macroeconomic variables in the forward-looking scenarios and their respective probability weightings, among other factors. Changes in any of these variables could have a material impact on the assessment of SICR and the measurement of allowance for expected credit losses.

The following table compares the probability weighted ECL (determined as the reported allowance for credit losses) against the base case ECL to illustrate the impact of applying probability weights to each of the scenarios in the determination of allowance for credit losses.

The differences presented in the following table is isolated to the measurement of ECL without considering the impact of migration between stages.

thousands of Canadian dollars

As at December 31, 2018

Probability-weighted ECL (reported allowance for credit losses)	\$ 51,691
Base case ECL	37,462
Difference	\$ 14,229

The following table presents the allowance for credit losses as at December 31, 2018 for all performing loans (total of Stage 1 and Stage 2 allowance for credit losses) compared to the allowance for credit losses that would result if all performing loans were measured as Stage 1 loans using 12-month ECL. The difference reflects the estimated impact of Stage 2 loans being measured using a lifetime ECL instead of a 12-month ECL, holding all risk profiles constant.

thousands of Canadian dollars	As at December 31, 2018
Reported allowance for credit losses for performing loans (Stage 1 and Stage 2)	\$ 32,671
Allowance for credit losses for performing loans if all measured as 12-month ECL	28,437
Remeasurement difference resulting from transfers from Stage 1 to Stage 2	\$ 4,234

The following table provides a continuity of the allowance for credit losses during the year by product and IFRS 9 Stage indicating components of the provision for credit losses as well as write-offs and recoveries.

thousands of Canadian dollars	For the year ended December 31, 2018			
	Stage 1	Stage 2	Stage 3	Total
<b>Single-family residential mortgages</b>				
Balance at the beginning of the year	\$ 11,610	\$ 7,280	\$ 3,563	\$ 22,453
New assets originated or purchased	34,844	—	—	34,844
Transfer from Stage 1	(6,903)	6,469	434	—
Transfer from Stage 2	8,568	(11,244)	2,676	—
Transfer from Stage 3	1,563	2,301	(3,864)	—
Remeasurement due to transfers	(3,389)	1,793	2,027	431
Change in risk parameters and models	(25,181)	290	13,746	(11,145)
Assets derecognized or repaid (excluding write-offs)	(5,913)	(2,665)	(10,072)	(18,650)
Provision for credit losses	3,589	(3,056)	4,947	5,480
Write-offs	(458)	(6)	(2,021)	(2,485)
Recoveries	—	—	611	611
<b>Balance at the end of the year</b>	<b>14,741</b>	<b>4,218</b>	<b>7,100</b>	<b>26,059</b>
of which is securitized	148	123	—	271
of which is non-securitized	14,593	4,095	7,100	25,788
<b>Commercial mortgages<sup>1</sup></b>				
Balance at the beginning of the year	3,898	3,318	3,300	10,516
New assets originated or purchased	5,205	—	—	5,205
Transfer from Stage 1	(2,594)	2,413	181	—
Transfer from Stage 2	3,490	(3,771)	281	—
Transfer from Stage 3	550	238	(788)	—
Remeasurement due to transfers	(910)	1,008	274	372
Change in risk parameters and models	(4,195)	(201)	11,251	6,855
Assets derecognized or repaid (excluding write-offs)	(920)	(563)	(557)	(2,040)
Provision for credit losses	626	(876)	10,642	10,392
Write-offs	(2)	—	(4,161)	(4,163)
Recoveries	—	—	29	29
<b>Balance at the end of the year</b>	<b>4,522</b>	<b>2,442</b>	<b>9,810</b>	<b>16,774</b>
of which is securitized	421	—	—	421
of which is non-securitized	4,101	2,442	9,810	16,353

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(unless otherwise stated, all amounts are in Canadian dollars)

### (C) Allowance for Credit Losses (Continued)

thousands of Canadian dollars

	For the year ended December 31, 2018			
	Stage 1	Stage 2	Stage 3	Total
<b>Credit card loans and lines of credit</b>				
Balance at the beginning of the year	\$ 823	\$ 1,965	\$ 1,196	\$ 3,984
New credit cards issued	289	—	—	289
Transfer from Stage 1	(444)	396	48	—
Transfer from Stage 2	1,401	(3,662)	2,261	—
Transfer from Stage 3	273	732	(1,005)	—
Remeasurement due to transfers	(406)	70	266	(70)
Change in risk parameters and models	(1,063)	2,452	884	2,273
Draws and repayments (excluding write-offs)	(45)	(463)	124	(384)
Provision for credit losses	5	(475)	2,578	2,108
Write-offs	(145)	(151)	(2,251)	(2,547)
Recoveries	—	—	158	158
<b>Balance at the end of the year</b>	<b>683</b>	<b>1,339</b>	<b>1,681</b>	<b>3,703</b>
<b>Other consumer retail loans</b>				
Balance at the beginning of the year	565	2,199	559	3,323
New assets originated or purchased	649	—	—	649
Transfer from Stage 1	(654)	651	3	—
Transfer from Stage 2	1,045	(1,331)	286	—
Transfer from Stage 3	13	213	(226)	—
Remeasurement due to transfers	(675)	1,077	13	415
Change in risk parameters and models	158	2,810	638	3,606
Assets derecognized or repaid (excluding write-offs)	(388)	(1,566)	(319)	(2,273)
Provision for credit losses	148	1,854	395	2,397
Write-offs	(6)	(34)	(527)	(567)
Recoveries	—	—	2	2
<b>Balance at the end of the year</b>	<b>707</b>	<b>4,019</b>	<b>429</b>	<b>5,155</b>
<b>Total allowance for credit losses</b>	<b>\$ 20,653</b>	<b>\$ 12,018</b>	<b>\$ 19,020</b>	<b>\$ 51,691</b>
<b>Total provision for credit losses</b>	<b>\$ 4,368</b>	<b>\$ (2,553)</b>	<b>\$ 18,562</b>	<b>\$ 20,377</b>

<sup>1</sup> Commercial mortgages include both non-residential commercial mortgages and residential commercial mortgages. Residential commercial mortgages include non-securitized multi-unit residential mortgages and commercial mortgages secured by residential property types.

The following provides explanations of the lines presented above:

- > Transfers between stages are presumed to occur before any corresponding remeasurement of the allowance.
- > New assets originated or purchased reflect the allowance related to assets newly recognized during the year, including renewals.
- > Assets derecognized or repaid (excluding write-offs) reflect the allowance related to assets derecognized during the year including loans subsequently renewed.
- > Remeasurement due to transfers represents the remeasurement between 12-month and lifetime ECLs due to stage transfers, excluding the changes to risk, parameters and models during the year.
- > Changes in risk parameters and models represent the change in the allowance related to the impact of macroeconomic factors, risk parameters, and changes to models. The change in risk parameters also includes the impact on ECL of the change in probability of default and loss given default that occurs with the passage of time as the loan approaches the end of its contractual term. This impact is more significant for loans with shorter contractual terms. In addition, the change in risk parameters includes the impact on ECL of the probability of default increasing to 100% when loans become non-performing and transfer into Stage 3.

## (C) Allowance for Credit Losses (Continued)

The changes to the Company's allowance for credit losses under IAS 39, for the year ended December 31, 2017 are presented below.

thousands of Canadian dollars

2017

	Single-family Residential Mortgages	Residential Commercial Mortgages	Non-residential Commercial Mortgages	Credit Card Loans and Lines of Credit	Other Consumer Retail Loans	Total
Individual allowances						
Allowance on loan principal						
Balance at the beginning of the year	\$ 1,980	\$ —	\$ 30	\$ 780	\$ 411	\$ 3,201
Provision for credit losses	2,216	16	2,816	5,387	531	10,966
Write-offs	(3,120)	(21)	(103)	(5,968)	(847)	(10,059)
Recoveries	653	5	7	258	181	1,104
	1,729	—	2,750	457	276	5,212
Allowance on accrued interest receivable						
Balance at the beginning of the year	1,341	—	98	—	12	1,451
Provision for credit losses	(325)	—	380	—	(5)	50
	1,016	—	478	—	7	1,501
Total individual allowance	2,745	—	3,228	457	283	6,713
Collective allowance						
Balance at the beginning of the year	23,032	327	9,500	3,904	300	37,063
Provision for credit losses <sup>1</sup>	(2,692)	—	(3,500)	(808)	3,500	(3,500)
	20,340	327	6,000	3,096	3,800	33,563
Total allowance	\$ 23,085	\$ 327	\$ 9,228	\$ 3,553	\$ 4,083	\$ 40,276
Total provision	\$ (801)	\$ 16	\$ (304)	\$ 4,579	\$ 4,026	\$ 7,516

<sup>1</sup> The reduction in the collective allowance of \$3.5 million during 2017 comprises the following:

- > Single-family residential mortgage portfolio – reduction of \$2.7 million reflecting the decrease in the portfolio size, decreased loss rates and continued low levels of loans in arrears.
- > Non-residential commercial mortgages portfolio – net reduction of \$3.5 million comprises a reduction of \$6.5 million, reflecting the sale of mortgages from this portfolio (please see Note 5(J) for more information), offset partially by an increase of \$3.0 million reflecting an increase in the construction and land segment of this portfolio.
- > Credit card loans and lines of credit portfolio – reduction of \$0.8 million, reflecting the decrease in the portfolio size, decreased loss rates and continued low levels of loans in arrears.
- > Other consumer retail loans portfolio – increase of \$3.5 million reflects settlement experience related to cash reserves on certain programs within this portfolio.

There were no individual provisions, allowances or net write-offs on securitized residential mortgages under IAS 39.

## (D) Credit Risk Exposure by Internal Risk Rating

The following table presents the gross carrying amounts of loans subject to IFRS 9 impairment requirements by internal risk ratings used by the Company for credit risk management purposes. The gross carrying amount of loans represents the maximum exposure to credit risk at the end of the reporting period without taking into account any collateral or other credit enhancements.

The internal risk ratings presented in the table below are defined as follows:

**Very low:** Loans that have significantly below average probability of default with credit risk that is significantly lower than the Company's risk appetite and risk tolerance levels. While the Company does originate loans under this category, these loans may have lower yield due to high credit quality.

**Low:** Loans that have below average probability of default with credit risk that is lower than the Company's risk appetite and risk tolerance levels. While the Company does originate loans under this category, these loans may have lower yield due to high credit quality.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(unless otherwise stated, all amounts are in Canadian dollars)

**Medium:** Loans that have an average probability of default with credit risk which is within the Company's risk appetite and risk tolerance. The Company actively originates loans under this category due to higher yields.

**High:** Loans that were originated within the Company's risk appetite but have subsequently experienced an increase in credit risk which is outside of the Company's typical risk appetite and risk tolerance levels. The Company will generally not originate loans in this category.

**Default:** Loans that are over 90 days past due or loans for which there is objective evidence of impairment.

thousands of Canadian dollars

	As at December 31, 2018			
	Stage 1	Stage 2	Stage 3	Total
<b>Single-family residential mortgages</b>				
Very Low	\$ 1,192,297	\$ —	\$ —	\$ 1,192,297
Low	8,267,116	65,745	—	8,332,861
Medium	2,958,261	298,139	—	3,256,400
High	413,871	304,737	—	718,608
Default	—	—	58,393	58,393
Gross carrying amount	12,831,545	668,621	58,393	13,558,559
Allowance for credit losses	(14,741)	(4,218)	(7,100)	(26,059)
Net carrying amount	12,816,804	664,403	51,293	13,532,500
<b>Commercial mortgages<sup>1</sup></b>				
Very Low	213,674	—	—	213,674
Low	892,157	97,474	—	989,631
Medium	509,514	215,648	—	725,162
High	4,293	16,271	—	20,564
Default	—	—	32,722	32,722
Gross carrying amount	1,619,638	329,393	32,722	1,981,753
Allowance for credit losses	(4,522)	(2,442)	(9,810)	(16,774)
Net carrying amount	1,615,116	326,951	22,912	1,964,979
<b>Credit card loans and lines of credit</b>				
Very Low	106,780	—	—	106,780
Low	137,079	2,817	—	139,896
Medium	112,602	27,832	—	140,434
High	3,185	10,713	—	13,898
Default	—	—	4,043	4,043
Gross carrying amount	359,646	41,362	4,043	405,051
Allowance for credit losses	(683)	(1,339)	(1,681)	(3,703)
Net carrying amount	358,963	40,023	2,362	401,348
<b>Other consumer retail loans</b>				
Very Low	19,122	—	—	19,122
Low	102,628	21,323	—	123,951
Medium	74,001	51,039	—	125,040
High	5,348	45,048	—	50,396
Default	—	—	515	515
Gross carrying amount	201,099	117,410	515	319,024
Allowance for credit losses	(707)	(4,019)	(429)	(5,155)
Net carrying amount	\$ 200,392	\$ 113,391	\$ 86	\$ 313,869

<sup>1</sup> Commercial mortgages include both non-residential commercial mortgages and residential commercial mortgages. Residential commercial mortgages include non-securitized multi-unit residential mortgages and commercial mortgages secured by residential property types.



## (E) Collateral

The Company holds collateral on all of its mortgage portfolio in the form of real property. The fair value of collateral held against mortgages is based on appraisals at the time a loan is originated. Appraisals are only updated should circumstances warrant. At December 31, 2018, the total appraised value of the collateral held for impaired mortgages (Stage 3), as determined when the mortgages were originated, was \$135.8 million (2017 – \$76.5 million).

The credit card loans and lines of credit portfolio comprises the Company's Equityline Visa (ELV), which is a home equity line of credit product, as well as secured and unsecured credit card loans. The Company's ELV loans are secured by residential property and represent 87.6% of the total credit card loans and lines of credit portfolio at December 31, 2018. Secured credit card loans are secured by cash deposits and represent 3.4% of the portfolio at December 31, 2018. Unsecured credit cards represent 9.0% of the portfolio at December 31, 2018.

Other consumer retail loans are primarily secured by charges on financed assets, primarily fixtures and/or improvements to residential property. Certain loans within the other consumer retail loan portfolio are advanced to the vendors who have underlying loans receivable from the end consumer. The Company holds a portion of the advanced amount on these loans as cash collateral.

## (F) Past Due Loans That Are Not Impaired – Comparative Information Required under IAS 39

thousands of Canadian dollars						As at December 31, 2017
	1 to 30 Days	31 to 60 Days	61 to 90 Days	Over 90 Days	Total	
Securitized single-family residential mortgages <sup>1</sup>	\$ 7,826	\$ 824	\$ 172	\$ — <sup>2</sup>	\$ 8,822	
Securitized multi-unit residential mortgages	—	—	—	—	—	
Single-family residential mortgages	130,553	27,561	5,932	3,138 <sup>2</sup>	167,184	
Residential commercial mortgages	833	—	823	—	1,656	
Non-residential commercial mortgages	9,812	2,023	—	—	11,835	
Credit card loans and lines of credit	2,361	1,051	883	253	4,548	
Other consumer retail loans	236	40	119	—	395	
	<b>\$ 151,621</b>	<b>\$ 31,499</b>	<b>\$ 7,929</b>	<b>\$ 3,391</b>	<b>\$ 194,440</b>	

<sup>1</sup> Securitized single-family residential mortgages include both CMHC-sponsored securitized insured mortgages and bank-sponsored securitization conduit uninsured mortgages.

<sup>2</sup> Insured residential mortgages were considered impaired when they were 365 days past due under IAS 39.

## (G) Impaired Loans and Individual Allowances for Credit Losses – Comparative Information under IAS 39

thousands of Canadian dollars							As at December 31, 2017
	Single-family Residential Mortgages	Residential Commercial Mortgages	Non-residential Commercial Mortgages	Credit Card Loans and Lines of Credit	Other Consumer Retail Loans	Total	
Gross amount of impaired loans	\$ 31,836	\$ —	\$ 16,489	\$ 2,038	\$ 276	\$ 50,639	
Individual allowances on principal	(1,729)	—	(2,750)	(457)	(276)	(5,212)	
Net amount of impaired loans	<b>\$ 30,107</b>	<b>\$ —</b>	<b>\$ 13,739</b>	<b>\$ 1,581</b>	<b>\$ —</b>	<b>\$ 45,427</b>	

## (H) Interest Income by Product

thousands of Canadian dollars		2018	2017
Traditional single-family residential mortgages		<b>\$ 477,612</b>	\$ 514,562
Accelerator single-family residential mortgages		<b>16,109</b>	13,974
Residential commercial mortgages		<b>11,527</b>	13,173
Non-residential commercial mortgages		<b>75,823</b>	97,421
Credit card loans and lines of credit		<b>32,420</b>	33,328
Other consumer retail loans		<b>30,879</b>	38,468
Total interest income on non-securitized loans		<b>644,370</b>	710,926
CMHC-sponsored securitized single-family residential mortgages		<b>65,683</b>	52,053
CMHC-sponsored securitized multi-unit residential mortgages		<b>24,166</b>	30,782
Assets pledged as collateral for CMHC-sponsored securitization		<b>1,550</b>	943
Bank-sponsored securitization conduit assets		<b>3,138</b>	6,151
Total interest income on securitized loans		<b>94,537</b>	89,929
		<b>\$ 738,907</b>	\$ 800,855

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(unless otherwise stated, all amounts are in Canadian dollars)

### (I) Loans by Remaining Contractual Term to Maturity (Gross of Allowance for Credit Losses)

thousands of Canadian dollars						December 31	December 31
	Within 1 Year	1 to 3 Years	3 to 5 Years	Over 5 Years	2018	2017	
					Total Book Value	Total Book Value	
Securitized single-family residential mortgages <sup>1</sup>	\$ 561,351	\$ 1,299,941	\$ 628,679	\$ —	\$ 2,489,971	\$ 2,435,208	
Securitized multi-unit residential mortgages	28,706	281,946	—	—	310,652	558,042	
Single-family residential mortgages	8,343,773	2,381,298	332,586	10,931	11,068,588	10,037,251	
Residential commercial mortgages	70,545	143,434	5,416	—	219,395	114,357	
Non-residential commercial mortgages	698,904	724,765	26,795	1,242	1,451,706	1,045,603	
Credit card loans and lines of credit	405,051	—	—	—	405,051	352,062	
Other consumer retail loans	31,536	75,914	181,188	30,386	319,024	361,166	
	\$ 10,139,866	\$ 4,907,298	\$ 1,174,664	\$ 42,559	\$ 16,264,387	\$ 14,903,689	

<sup>1</sup> Securitized single-family residential mortgages include both CMHC-sponsored securitized insured mortgages and bank-sponsored securitization conduit uninsured mortgages.

### (J) Sale of Loan Portfolios

The Company did not sell any mortgages in 2018. In 2017, the Company sold mortgages for proceeds of \$1.49 billion resulting in the recognition of \$18.2 million of losses included in non-interest income (loss) in the consolidated statements of income.

During 2018, the Company recognized a recovery of \$4.5 million of losses on the 2017 sale of commercial mortgages in non-interest income (loss) in the consolidated statements of income.

### (K) Revenue from Contracts with Customers

Included within fees and other income in the consolidated statements of income is \$47.1 million (2017 – \$66.5 million) of revenue recognized from contracts with customers. The associated receivables from contracts with customers of \$29.3 million (2017 – \$22.8 million) are included within loans on the consolidated balance sheets.

## 6. Securitization Activity

### (A) Assets Pledged as Collateral

As a requirement of the NHA MBS and CMB programs, the Company assigns to CMHC all of its interest in CMHC-sponsored securitized mortgage pools. If the Company fails to make timely payment under an NHA MBS or CMB security, CMHC may enforce the assignment of the mortgages included in all the mortgage pools as well as other assets backing the MBS issued.

The Company previously participated in a bank-sponsored securitization conduit program to provide for cost-effective funding of the Company's ACE Plus product. Under the program, the assigned mortgages remain in the program until maturity and the sponsoring bank retains all of the refinancing risks related to the program, with the Company bearing no risk for funding the program. Currently, the conduit is not available for new assignments of mortgages.

The following table presents the activity associated with the principal value of the Company's on-balance sheet mortgage loans and other assets assigned as collateral for both the CMHC- and bank-sponsored securitization programs. The mortgages are recorded as securitized single-family or multi-unit residential mortgages and assets assigned as CMB replacement assets are recorded as restricted assets.

thousands of Canadian dollars	2018	2017
Beginning balance of on-balance sheet assets assigned as collateral for securitization <sup>1</sup>	\$ 3,176,127	\$ 2,648,882
Mortgages assigned in new securitizations	1,062,428	2,007,633
Net change in acceptable securities assigned as replacement assets	(135,887)	60,799
Mortgages derecognized <sup>2</sup>	(650,675)	(799,271)
Maturity, amortization and changes in mortgages assigned as CMB replacement assets	(604,380)	(741,916)
Ending balance of on-balance sheet assets assigned as collateral for securitization <sup>1</sup>	\$ 2,847,613	\$ 3,176,127

<sup>1</sup> Included in the on-balance sheet assets assigned as collateral at December 31, 2018 is \$47.0 million (2017 – \$182.9 million) in acceptable securities assigned as replacement assets and \$2.80 billion (2017 – \$2.99 billion) of securitized mortgages.

<sup>2</sup> Mortgages are derecognized upon the sale of residual interests in insured single-family residential mortgages and the securitization and sale of multi-unit residential mortgages.

Acceptable securities assigned as collateral were accounted for as debt instrument financial assets measured at amortized cost (available for sale assets under IAS 39 in 2017) and included in restricted assets on the consolidated balance sheets. Please see Note 7 for more information. Additionally, off-balance sheet mortgage loans of \$6.54 billion (2017 – \$7.44 billion) were assigned as collateral related to CMHC for sponsored securitization programs. Included in this amount is \$0.33 billion (2017 – \$0.82 billion) of mortgages that were sold under the former whole loan sales program of Home Bank. These mortgages were securitized subsequent to the whole loan sales by the purchaser.

## (B) Securitization Liabilities

The following table presents the securitization liabilities, including liabilities added during the year, which are secured by insured mortgages for CMHC-sponsored securitizations, uninsured mortgages for the bank-sponsored securitization conduit and other restricted assets. This table includes only on-balance sheet originations and discharges.

thousands of Canadian dollars	2018	2017
Balance at the beginning of the year	\$ 3,177,749	\$ 2,649,649
Addition to securitization liabilities as a result of on-balance sheet activity	411,753	1,496,819
Net reduction in securitization liabilities due to maturities, amortization and sales	(732,207)	(966,328)
Other <sup>1</sup>	2,031	(2,391)
Securitization liability	\$ 2,859,326	\$ 3,177,749
Proceeds received for mortgages assigned in new securitizations	\$ 1,047,258	\$ 1,980,441

<sup>1</sup> Other includes premiums, discounts, transaction costs and changes in the mark to market of hedged items.

The following table provides the remaining contractual term to maturity of securitization liabilities.

thousands of Canadian dollars, except %					December 31 2018	December 31 2017
	Within 1 Year	1 to 3 Years	3 to 5 Years	Over 5 Years	Total Book Value	Total Book Value
CMHC-sponsored mortgage-backed security liabilities	\$ 235,668	\$ 657,843	\$ 679,705	\$ —	\$ 1,573,216	\$ 1,562,152
Contractual yield	2.1%	1.7%	2.2%	—	2.0%	1.6%
CMHC-sponsored Canada Mortgage Bond liabilities	—	1,105,982	133,349	—	1,239,331	1,473,318
Contractual yield	—	2.6%	1.7%	—	2.5%	2.8%
Bank-sponsored securitization conduit liabilities	39,775	7,004	—	—	46,779	142,279
Contractual yield	2.1%	2.1%	—	—	2.1%	2.1%
	\$ 275,443	\$ 1,770,829	\$ 813,054	\$ —	\$ 2,859,326	\$ 3,177,749

## (C) Securitization Income

The following table presents the total securitization income for the year.

thousands of Canadian dollars	2018	2017
Net gain on sale of mortgages and residual interest <sup>1</sup>	\$ 4,633	\$ 5,695
Net change in unrealized gain or loss on hedging activities	8	(247)
Servicing income	5,899	7,081
Total securitization income	\$ 10,540	\$ 12,529

<sup>1</sup> Gain on sale of mortgages and residual interest are net of hedging impact.

The hedging activities included in the previous table hedge interest rate risk on loans held for sale. The derivatives, which are typically bond forwards, are not designated in hedge accounting relationships. The gains or losses on the derivatives are mostly offset by the fair value changes related to the loans held for sale.

During the year, the Company securitized and sold through the NHA MBS program certain insured multi-unit residential mortgages with no prepayment privileges. These mortgages are recognized on the Company's consolidated balance sheets only to the extent of the Company's continuing involvement in the mortgages (continuing involvement accounting). The Company's continuing involvement is limited to its retained interest and its obligations for mortgage servicing. There is no prepayment or credit risk associated with the retained interest or the cost of servicing. The mortgages are effectively derecognized as a result of this transaction. The retained interest and servicing liability are recorded on the consolidated balance sheets in other assets and other liabilities, respectively.

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In 2017, the Company also sold residual interests in certain pools of insured single-family residential mortgages securitized through the NHA MBS program. The sales resulted in the Company transferring substantially all of the risks and rewards of ownership associated with the underlying mortgages. As a result, the mortgages were derecognized and a gain on sale was recognized.

The gains on both of the above transaction types are included in non-interest income under securitization income in the consolidated statements of income.

The following table provides additional quantitative information about these securitization and sales activities during the year.

thousands of Canadian dollars	2018			2017		
	Single-family Residential MBS	Multi-unit Residential MBS	Total MBS	Single-family Residential MBS	Multi-unit Residential MBS	Total MBS
Carrying value of underlying mortgages derecognized	\$ —	\$ 650,675	\$ 650,675	\$ 288,458	\$ 510,813	\$ 799,271
Net gains on sale of mortgages or residual interest <sup>1</sup>	—	4,633	4,633	2,084	3,611	5,695
Retained interests recorded	—	24,981	24,981	—	20,815	20,815
Servicing liability recorded	—	5,008	5,008	—	4,943	4,943

<sup>1</sup> Gains on sale of mortgages or residual interest are net of hedging impact.

## 7. Restricted Assets

thousands of Canadian dollars	December 31 2018	December 31 2017
Restricted cash		
Restricted cash – CMHC- and bank-sponsored securitization programs	\$ 162,535	\$ 158,569
Restricted cash – derivatives	77,350	59,391
Restricted cash – other programs	22,330	36,174
Total restricted cash	262,215	254,134
Acceptable securities assigned as replacement assets	46,990	182,877
Total restricted assets	\$ 309,205	\$ 437,011

*Restricted cash – CMHC- and bank-sponsored securitization programs* represent deposits held as collateral by the sponsors in connection with the Company's securitization activities.

*Restricted cash – derivatives* are deposits held by counterparties as collateral for the Company's swap and bond forward transactions. The terms and conditions for the collateral are governed by International Swaps and Derivatives Association (ISDA) agreements.

*Restricted cash – other programs* include reserve accounts held in trust for certain portfolios included in other consumer retail loans. These amounts are held as cash collateral against potential credit losses. In addition, other programs include account balances held in trust for the whole loan sales program.

The following table provides the remaining contractual term to maturity of restricted cash and acceptable securities assigned as CMB replacement assets. Please see Note 6(A) for more information.

thousands of Canadian dollars	December 31 2018					December 31 2017	
	Within 1 Year	1 to 3 Years	3 to 5 Years	Over 5 Years	Total Fair Value	Total Fair Value	
Restricted cash	\$ 262,215	\$ —	\$ —	\$ —	\$ 262,215	\$ 254,134	
Acceptable securities assigned as replacement assets	46,990	—	—	—	46,990	182,877	
	\$ 309,205	\$ —	\$ —	\$ —	\$ 309,205	\$ 437,011	

## 8. Other Assets

thousands of Canadian dollars	December 31 2018	December 31 2017
Accrued interest receivable	\$ 55,469	\$ 49,651
Prepaid CMB coupon	2,895	3,644
Securitization receivable and retained interest	162,256	182,930
Capital assets	8,665	10,431
Income taxes recoverable	37,282	13,340
Other prepaid assets and deferred items	72,420	76,774
	<b>\$ 338,987</b>	<b>\$ 336,770</b>

## 9. Intangible Assets

The following table presents the net carrying amount of the Company's intangible assets as at December 31, 2018 and 2017, along with the changes in net carrying amount for the years ended December 31, 2018 and 2017.

thousands of Canadian dollars	2018	2017
Cost		
Balance at the beginning of the year	\$ 162,363	\$ 161,426
Additions from internal development	4,424	8,952
Acquisition of intangible assets	—	334
Impairment loss	(537)	(8,349)
Balance at the end of the year	166,250	162,363
Accumulated amortization		
Balance at the beginning of the year	63,694	46,423
Amortization expense	19,124	17,271
Balance at the end of the year	82,818	63,694
Carrying amount at the end of the year	<b>\$ 83,432</b>	<b>\$ 98,669</b>

The net carrying amounts of the Company's intangible assets at December 31, 2018 and 2017 relate solely to internally developed software costs. As at December 31, 2018, there was \$3.0 million (2017 – \$7.0 million) in work in progress on internally developed software that was not being amortized.

The Company performed an impairment assessment for its intangible assets by estimating the recoverable amount of the CGU to which the assets belong and comparing to carrying value. The recoverable amount of the CGU was determined using an internally developed discounted cash flow model that considers various assumptions such as the Company's forecasted earnings, growth rate, and discount rate. The impairment assessment concluded that the recoverable amount closely approximated carrying value as at December 31, 2018. As a result, no impairment charge was recognized. Estimation of the recoverable amount is an area of significant judgement. Reductions in the estimated recoverable amount could arise from various factors, such as reductions in forecasted earnings and any adverse changes to the discount rate or the long-term growth rate.

During 2018, the Company recognized a total impairment loss on intangible assets of \$0.5 million that have become obsolete. It has been determined that the benefits from these components may not be realized and the capitalized amount is not recoverable. The impairment of these components does not impact the functionality of the systems currently in use. In addition, upon a reassessment of useful lives, amortization on a number of assets was accelerated on a prospective basis as it was determined that their remaining effective useful life was shorter than originally estimated. Incremental amortization of \$1.1 million resulting from the change in estimated useful life and the impairment loss are included in other operating expenses on the consolidated statements of income.

During 2017, the Company recognized a total impairment loss on specific intangible assets of \$8.3 million. An impairment loss of \$6.3 million was recognized on components of the Company's internally developed software that had become obsolete. It was determined that the benefits from these components would not be realized and the capitalized amount was not recoverable. The impairment of these components does not impact the functionality of the systems currently in use. The remaining \$2.0 million of impairment loss was recognized on other acquired intangible assets within the former prepaid card business. The net carrying value of other acquired intangible assets was \$nil at December 31, 2017. The \$8.3 million impairment loss was included in other operating expenses on the consolidated statements of income. In 2017, the Company also revised the estimated useful life of a substantial component of its internally developed software from 15 years to 14 years as a result of expected future upgrades, and this change in estimate was applied prospectively.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(unless otherwise stated, all amounts are in Canadian dollars)

### 10. Goodwill

Goodwill as at December 31, 2018 and 2017 of \$2.3 million relates entirely to Home Trust. There were no additions, disposals or impairments of goodwill for the year ended December 31, 2018.

During 2017, the Company determined that it would exit its payment processing and prepaid card business through a sale transaction. This included the Company's former subsidiary PSiGate. In connection with this decision, the Company recorded a write-down of the remaining goodwill related to PSiGate in the amount of \$4.4 million, based on the estimated fair value less costs to sell. The write-down was included in other operating expenses in the consolidated statements of income. On February 1, 2018, the Company completed its sale of PSiGate. See Note 22 for more information.

### 11. Deposits by Remaining Contractual Term to Maturity

	December 31 2018					December 31 2017
thousands of Canadian dollars, except %	Payable on Demand	Within 1 Year	1 to 3 Years	3 to 5 Years	Total	Total
Deposits payable on demand						
High-interest savings accounts	\$ 147,183	\$ —	\$ —	\$ —	\$ 147,183	\$ 138,948
Oaken savings accounts	194,218	—	—	—	194,218	229,511
Other deposits payable on demand	95,645	—	—	—	95,645	170,905
	<b>437,046</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>437,046</b>	<b>539,364</b>
Deposits payable on fixed dates						
Brokered GICs <sup>1</sup>	—	4,453,892	3,895,915	1,703,473	10,053,280	9,350,235
Oaken GICs <sup>1</sup>	—	1,415,397	771,120	300,247	2,486,764	1,805,332
Institutional deposit notes	—	—	—	—	—	475,523
	<b>—</b>	<b>5,869,289</b>	<b>4,667,035</b>	<b>2,003,720</b>	<b>12,540,044</b>	<b>11,631,090</b>
Total deposits	<b>\$ 437,046</b>	<b>\$ 5,869,289</b>	<b>\$ 4,667,035</b>	<b>\$ 2,003,720</b>	<b>\$ 12,977,090</b>	<b>\$ 12,170,454</b>
Average contractual yield	1.6%	2.4%	2.6%	3.0%	2.6%	2.2%

<sup>1</sup> Included in Brokered and Oaken GICs presented above as payable within one year are \$148.8 million of cashable GICs that have reached the required number of days to be payable on demand. In the absence of such demand, the GICs have a remaining contractual term to maturity of within one year.

### 12. Other Liabilities

	December 31 2018	December 31 2017
thousands of Canadian dollars		
Accrued interest payable on deposits	\$ 155,112	\$ 125,965
Accrued interest payable on securitization liabilities	7,808	7,923
Securitization servicing liability	21,178	20,924
Other, including accounts payable and accrued liabilities	154,246	205,665
	<b>\$ 338,344</b>	<b>\$ 360,477</b>

### 13. Capital

#### (A) Authorized

An unlimited number of common shares with no par value

An unlimited number of preferred shares, issuable in series, to be designated as senior preferred shares

An unlimited number of preferred shares, issuable in series, to be designated as junior preferred shares

## (B) Common Shares Issued and Outstanding

thousands	2018		2017	
	Number of Shares	Amount	Number of Shares	Amount
Outstanding at the beginning of the year	80,246	\$ 231,156	64,388	\$ 84,910
Options exercised	—	—	16	548
Repurchase of shares	(18,181)	(52,374)	(203)	(267)
Issuance of shares	—	—	16,045	145,965
Outstanding at the end of the year	62,065	\$ 178,782	80,246	\$ 231,156

The Company has no preferred shares outstanding.

## (C) Repurchase of Shares

On December 21, 2018, the Company repurchased for cancellation 18,181,818 common shares at a price of \$16.50 per share totalling \$300 million under its substantial issuer bid (SIB). The purchase price of shares acquired through the SIB is allocated between capital stock and retained earnings. The reduction to capital stock for the year ended December 31, 2018 was \$52.4 million. The balance of the purchase price of \$247.6 million was charged to retained earnings along with \$0.5 million (net of tax) for transaction costs associated with the SIB.

During 2017, the Company repurchased 203,000 common shares under its Normal Course Issuer Bid (NCIB) for \$6.0 million. The purchase price of shares acquired through the NCIB is allocated between capital stock and retained earnings. The reduction to capital stock for the year ended December 31, 2017 was \$0.3 million. The balance of the purchase price of \$5.7 million was charged to retained earnings.

Subsequent to the end of 2018, the Company implemented an NCIB that was approved by the Toronto Stock Exchange and has commenced repurchases of common shares under the NCIB. Please see Note 24 for more information.

## (D) Issuance of Shares

The Company did not issue new common shares in 2018. On June 29, 2017, the Company issued 16,044,580 new common shares at a price of \$9.55 per share to Columbia Insurance Company, a wholly owned subsidiary of Berkshire Hathaway Inc., for proceeds of \$153.2 million. The amount recorded in capital stock in 2017 reflects the proceeds received net of \$9.8 million (\$7.3 million, net of tax) of associated professional fees and other transaction costs.

## (E) Earnings per Common Share (EPS)

Basic earnings per common share of \$1.66 (2017 – \$0.10) is determined as net income for the year divided by the average number of common shares outstanding of 79,748,217 (2017 – 72,348,998).

Diluted earnings per common share of \$1.66 (2017 – \$0.10) is determined as net income for the year divided by the average number of common shares outstanding of 79,748,217 (2017 – 72,348,998) plus the stock options potentially exercisable, as determined under the treasury stock method, of nil (2017 – 8,871) for a total of 79,748,217 (2017 – 72,357,869) diluted common shares.

## (F) Capital Management

The Company has a Capital Management Policy that governs the quantity and quality of capital held. The objectives of the policy are to ensure that capital levels are adequate and that Home Trust meets all regulatory capital requirements, while also providing a sufficient return to investors. The Risk and Capital Committee and the Board review the policy annually and monitor compliance with the policy on a quarterly basis.

The Company's subsidiary, Home Trust, is subject to the regulatory capital requirements stipulated by OSFI. These requirements are consistent with international standards (Basel II and Basel III) set by the Bank for International Settlements. Home Trust follows the Basel II Standardized Approach for calculating credit risk and the Basic Indicator Approach for operational risk. In addition, the declaration and payment of dividends by Home Trust to Home Capital are subject to restrictions under the *Trust and Loan Companies Act* (Canada).



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(unless otherwise stated, all amounts are in Canadian dollars)

The regulatory capital position of Home Trust was as follows:

	December 31 2018	December 31 2017	National Regulatory Minimum
Regulated capital to risk-weighted assets			
Common equity tier 1 ratio	18.94%	23.17%	7.00%
Tier 1 capital ratio	18.93%	23.17%	8.50%
Total regulatory capital ratio	19.38%	23.68%	10.50%

Home Trust adopted certain Basel III capital requirements, as required by OSFI, beginning January 1, 2013. The transitional basis allowed for the transition of certain capital deductions over a period ending January 1, 2018, whereas the all-in basis included all applicable deductions immediately. For purposes of meeting minimum regulatory capital ratios prescribed by OSFI, the all-in basis was required. The regulatory capital ratios as at December 31, 2017 and the national regulatory minimum presented above are on an all-in basis. Home Trust is required to meet a minimum Leverage ratio determined by OSFI. As at December 31, 2018, the Leverage ratio was 7.54% (2017 – 8.70%), which exceeds OSFI's minimum requirements.

Home Trust's Common Equity Tier 1, Total Tier 1, and Total capital ratios exceed OSFI's regulatory targets, as well as Home Trust's internal capital targets. The Company's capital position was reduced through the repurchase of shares for cancellation under the SIB (please see Note 13(C)).

## 14. Employee Benefits

### (A) Employee Share Purchase Plan

Under the Employee Share Purchase Plan, every year eligible employees can elect to purchase common shares of the Company up to 10% of their annual earnings. The Company matches 50% of the employees' contribution amount. During each pay period, all contributions are used by the plan's trustee to purchase the common shares in the open market. The Company's contributions are fully vested immediately. The Company's contributions are expensed as paid and totalled \$1.0 million for 2018 (2017 – \$1.3 million).

### (B) Employee Retirement Savings Plan

During the year, Home Trust contributed \$1.1 million (2017 – \$1.3 million) to the employee group registered retirement savings plan.

### (C) Stock Options

The details and changes in the issued and outstanding options are as follows:

thousands, except per share amounts and years	2018		2017	
	Number of Shares	Weighted- average Exercise Price	Number of Shares	Weighted- average Exercise Price
Outstanding at the beginning of the year	840	\$ 33.40	1,074	\$ 32.73
Granted	211	15.20	160	22.79
Exercised	—	—	(16)	25.03
Forfeited	(153)	37.30	(142)	32.58
Expired	—	—	(236)	24.21
Outstanding at the end of the year	898	\$ 28.45	840	\$ 33.40
Exercisable at the end of the year	471	\$ 35.48	511	\$ 35.85
Weighted-average market price per share at date of exercise		\$ N/A		\$ 26.37
Weighted-average remaining contractual life in years		2.3		2.8

The Company's stock option plan was approved by the shareholders of the Company on December 31, 1986. The plan was amended in 2002 to conform to the Toronto Stock Exchange's Revised Policy on Listed Company Share Incentive Arrangements. During 2010, the Company approved an amendment to the Employee Stock Option Plan to provide stock appreciation rights that allow cash settlement of vested stock options, at the Company's discretion. No options were settled in cash in 2018 or 2017. During Q2 2014, the Company amended its Employee Stock Option Plan to allow options to be exercised, as they vest, at a rate of 25% each year. Previously, stock options could not be exercised until the end of the four-year vesting period.

As at December 31, 2018, the maximum number of options on common shares that could be issued was 10,670,396, representing approximately 17.2% of the aggregate number of common shares. The exercise price of the options is fixed by the Board at the time of grant at the market price of such shares, subject to all applicable regulatory requirements. The exercise period of any vested option is



limited to a period of five or seven years from the date of grant of the option as determined in each case by the Board. Stock options that are currently issued and outstanding vest at a rate of 25% per year over four years, provided that predetermined conditions including vesting conditions, such as earnings per share targets, are achieved for each year as established by the Board at the time of the grant.

As at December 31, 2018, the weighted-average exercise prices for stock options outstanding to acquire common shares ranged from \$14.96 to \$46.98. The weighted-average range of exercise prices for stock options outstanding and exercisable are presented below along with the number of options outstanding and exercisable and the weighted-average contractual life remaining.

	Stock options outstanding			As at December 31, 2018	
	Number Outstanding	Weighted-average Contractual Life Remaining in Years	Weighted-average Exercise Price	Stock options exercisable	
				Number Exercisable	Weighted-average Exercise Price
Range of exercise prices					
Less than \$20.00	268,374	4.1	\$ 14.96	2,047	\$ 14.99
\$20.01 – \$25.00	46,500	0.6	23.25	46,500	23.25
\$25.01 – \$30.00	297,897	1.8	28.83	164,046	29.31
\$30.01 – \$35.00	38,750	1.9	31.98	26,250	32.00
\$35.01 – \$40.00	130,000	1.9	39.65	130,000	39.65
\$40.01 – \$45.00	—	—	—	—	—
Over \$45.00	116,450	0.9	46.98	102,624	46.92
	<b>897,971</b>	<b>2.3</b>	<b>\$ 28.45</b>	<b>471,467</b>	<b>\$ 35.48</b>

The Company determined the fair value of options granted prior to the September 2017 grant using the Black-Scholes option pricing model. Starting with the September 2017 grant, the Company began using the binomial option pricing model, prospectively, as it more accurately reflects the impact of the volatility and dividend assumptions in the valuation of options granted. The weighted-average fair value of the options granted during the year was \$4.01 (2017 – \$4.67).

The following assumptions were used to determine the fair value of each of the following option grants on the date of grant:

Canadian dollars, except % and years	May 2018	March 2018	December 2017	September 2017	February 2017
Fair value of options granted	\$ 3.74	\$ 4.03	\$ 4.40	\$ 4.23	\$ 4.94
Share price	\$ 14.03	\$ 15.43	\$ 16.85	\$ 14.00	\$ 27.65
Exercise price	\$ 14.15	\$ 15.25	\$ 17.36	\$ 13.90	\$ 27.65
Expected share price volatility	39.0%	38.4%	38.7%	42.7%	32.7%
Expected period until exercise in years <sup>1</sup>	4.0	4.0	3.8	3.8	3.8
Forfeiture rate	—	—	—	—	5.0%
Expected dividend yield	3.26%	3.26%	3.53%	3.60%	3.95%
Risk-free rate of return	2.73%	2.45%	2.05%	2.15%	1.01%
Valuation model	Binomial	Binomial	Binomial	Binomial	Black Scholes

<sup>1</sup> Exercisable upon vesting.

The above assumptions for expected volatility were determined on the basis of historical volatility.

The Company determines the fair value of stock options on the grant date and records this amount as compensation expense over the period that the stock options vest, with a corresponding change to contributed surplus. In 2018, \$0.4 million was recognized as a net reduction to compensation expense resulting from grants cancelled by forfeiture where certain vesting conditions were not satisfied (2017 – compensation expense of \$0.6 million). When these stock options are exercised, the Company records the amount of proceeds, together with the amount recorded in contributed surplus, in capital stock (2018 – \$nil; 2017 – \$0.4 million).

## (D) Deferred Share Units (DSUs)

The Company grants DSUs to non-employee Directors of the Company. Under the plan, the non-employee Directors may elect annually to accept remuneration in the form of cash and DSUs or only DSUs. DSUs earn dividend equivalents in the form of additional DSUs at the same rate as dividends on common shares. The participant is not allowed to settle the DSUs until retirement or termination of directorship. The cash value of the DSUs is equivalent to the market value of common shares when settlement takes place. The fair value of the DSU liability as at December 31, 2018 was \$2.7 million (2017 – \$4.0 million). As of December 31, 2018, there were 187,861 DSUs outstanding (2017 – 217,791).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(unless otherwise stated, all amounts are in Canadian dollars)

### (E) Restricted Share Units (RSUs)

The Company grants RSUs to certain key members of management. The RSUs generally vest over three years and the vested amount is settled on the vesting date. RSUs earn dividend equivalents in the form of additional RSUs at the same rate as dividends on common shares. The cash value of the RSUs is equivalent to the market value of common shares on the vesting date. The fair value of the RSU liability as at December 31, 2018 was \$592 thousand (2017 – \$277 thousand). As of December 31, 2018, there were 76,467 RSUs outstanding (2017 – 60,705 RSUs outstanding).

### (F) Performance Share Units (PSUs)

The Company grants PSUs to certain key members of management. The PSUs vest after three years on the condition that certain performance criteria are met. The vested amount is settled on the vesting date. PSUs earn dividend equivalents in the form of additional PSUs at the same rate as dividends on common shares. The cash value of the PSUs is equivalent to the market value of common shares on the vesting date multiplied by a performance factor ranging from 50% to 150%. The fair value of the PSU liability as at December 31, 2018 was \$0.6 million, and there were 146,250 PSUs outstanding (2017 – \$1.2 million and 76,598 PSUs outstanding).

### (G) Share-based Compensation Expense

The expense recognized in the consolidated statements of income in relation to share-based compensation was as follows:

thousands of Canadian dollars	2018	2017
(Decrease) increase to expense arising from equity-settled share-based payment transactions	\$ (395)	\$ 557
DSUs, RSUs and PSUs (representing all expenses arising from cash-settled share-based payment transactions)	104	2,065
	<b>\$ (291)</b>	<b>\$ 2,622</b>

## 15. Accumulated Other Comprehensive Income

The following table presents the components of AOCI. The balances pertaining to 2018 are presented according to their classifications under IFRS 9. The balances as at December 31, 2017 are presented according to their classification under IAS 39. N/A indicates not applicable under the accounting policy for the respective period. As indicated in Note 2, there was no adjustment to opening AOCI upon adoption of IFRS 9 as the adoption of IFRS 9 did not result in a measurement difference. Accordingly, the impact of adoption of IFRS 9 was limited to the reclassification to the IFRS 9 categories from the previous IAS 39 categories. The balances as at January 1, 2018 have been presented below to illustrate these reclassifications from the December 31, 2017 classifications under IAS 39.

thousands of Canadian dollars	December 31 2018	January 1 2018	December 31 2017
Unrealized losses on			
Equity securities designated at FVOCI	\$ (13,988)	\$ (9,405)	N/A
Income tax recovery	(3,725)	(2,503)	N/A
	<b>(10,263)</b>	<b>(6,902)</b>	<b>N/A</b>
Unrealized gains on			
Debt instruments at FVOCI	1,874	2,980	N/A
Income tax expense	490	783	N/A
	<b>1,384</b>	<b>2,197</b>	<b>N/A</b>
Unrealized losses on			
Available for sale securities and retained interests	N/A	N/A	(6,425)
Income tax recovery	N/A	N/A	(1,720)
	<b>N/A</b>	<b>N/A</b>	<b>(4,705)</b>
Unrealized losses on			
Cash flow hedges	(2,174)	(1,606)	(1,606)
Income tax recovery	(568)	(417)	(417)
	<b>(1,606)</b>	<b>(1,189)</b>	<b>(1,189)</b>
Accumulated other comprehensive loss	<b>\$ (10,485)</b>	<b>\$ (5,894)</b>	<b>\$ (5,894)</b>

## 16. Income Taxes

### (A) Reconciliation of Income Taxes

The combined federal and provincial income tax rate varies each year depending on changes in the statutory tax rate imposed by the federal and provincial governments. The effective rate of income tax in the consolidated statements of income is the same as the statutory tax rate of 26.50% (2017 – 26.50%).

thousands of Canadian dollars	2018	2017
Income before income taxes	\$ 180,402	\$ 8,915
Income taxes at statutory combined federal and provincial income tax rates	\$ 47,807	\$ 2,362
Increase (decrease) in income taxes at statutory income tax rates resulting from		
Tax-exempt income	(334)	(873)
Non-deductible items	—	2,085
Scientific research and experimental development investment tax credits	(575)	(1,483)
Other	901	(703)
Income tax	\$ 47,799	\$ 1,388

### (B) Reconciliation of Income Tax Rates

	2018	2017
Statutory income tax rate	26.50%	26.50%
Increase (reduction) in income tax rate resulting from		
Tax-exempt income	(0.18)%	(9.79)%
Non-deductible items	—	23.39%
Scientific research and experimental development investment tax credits	(0.32)%	(16.63)%
Other	0.50%	(7.90)%
Effective income tax rate	26.50%	15.57%

### (C) Sources of Deferred Tax Balances

thousands of Canadian dollars	December 31 2018	December 31 2017
Deferred tax liabilities		
Commissions	\$ 7,028	\$ 6,690
Finders' fees, net of commitment fees	2,056	3,693
Securitization transaction costs	5,100	4,659
Swaps	541	541
Development costs	22,182	26,244
Other	1,946	607
	38,853	42,434
Deferred tax assets		
Allowance for credit losses	8,991	9,432
Loss carryforwards	1,248	8,341
Deferred share unit plan expenses	1,034	1,448
Deferred financing costs	2,144	2,040
Capital assets	87	520
	13,504	21,781
Net deferred tax liability	\$ 25,349	\$ 20,653

Net deferred tax liabilities on the consolidated balance sheets were \$28.8 million (December 31, 2017 – \$30.2 million) and deferred tax assets were \$3.5 million (December 31, 2017 – \$9.6 million). The deferred tax liability comprises deferred tax on commissions, finders' fees, transaction costs, development costs and tax credits. The deferred tax liability is presented net of certain deferred tax assets, primarily attributed to allowance for credit losses. The deferred tax asset presented on the consolidated balance sheets includes deferred financing costs related to share issuance costs, which were accounted for as a deduction from shareholders' equity.

Capital losses totalling \$1.2 million for Home Capital (December 31, 2017 – \$2.7 million) are available to reduce capital gains in future years. The future tax benefits arising from application of these losses have not been reflected in the consolidated statements of income and changes in shareholders' equity.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(unless otherwise stated, all amounts are in Canadian dollars)

During the year, the Company also recognized Scientific Research and Experimental Development investment tax credits related to the development of its internally generated software. The investment tax credits are recorded as a reduction of tax provisions, net of any tax that would be eligible on such benefit.

# 17. Commitments and Contingencies

## (A) Lease Commitments

The Company has entered into commercial leases on premises and property, as well as certain computer hardware and software leases. There are no restrictions imposed by lease arrangements. Future minimum lease payments under non-cancellable operating leases are as follows:

thousands of Canadian dollars	December 31 2018	December 31 2017
Within one year	\$ 11,698	\$ 12,862
After one year but not more than five years	32,313	19,734
More than five years	18,261	21,803
	<b>\$ 62,272</b>	<b>\$ 54,399</b>

Lease payments recognized as an expense in the consolidated statements of income amounted to \$23.0 million in 2018 (2017 – \$25.3 million).

## (B) Credit Commitments

Outstanding amounts for future advances on mortgage loans amounted to \$1.00 billion as at December 31, 2018 (2017 – \$875.9 million). These amounts include offers made but not yet accepted by the customers as of the reporting date. Also, included within the outstanding amounts are unutilized non-residential commercial loan advances of \$386.7 million at December 31, 2018 (2017 – \$196.7 million). Offers for loans remain open for various periods. The average rate on mortgage offers is 5.22% (2017 – 4.57%).

The Company also has contractual amounts to extend credit to its clients for its credit card products. The contractual amounts for these products represent the maximum potential credit risk, assuming that all the contractual amounts are fully utilized, the clients default and collection efforts are unsuccessful. At December 31, 2018, these contractual amounts in aggregate were \$760.3 million (2017 – \$497.5 million), of which \$355.8 million (2017 – \$145.5 million) had not been drawn by customers. Included in the outstanding amounts for future advances of mortgage loans are outstanding future advances for the Equityline Visa portfolio of \$28.6 million at December 31, 2018 (2017 – \$16.1 million).

These amounts in aggregate are not indicative of total future cash requirements. Management does not expect any material adverse consequence to the Company's financial position to result from these amounts. Secured credit cards have spending limits restricted by collateral held by the Company.

## (C) Directors' and Officers' Indemnification

The Company indemnifies Directors and officers, to the extent permitted by law, against certain claims that may be made against them as a result of their being, or having been, Directors and officers at the request of the Company. The nature of this indemnification prevents the Company from making a reasonable estimate of the maximum potential amount the Company could be required to pay to third parties. Management believes that the likelihood that the Company would incur a significant liability under these indemnifications is remote. The Company has purchased Directors' and officers' liability insurance.

## (D) Provisions and Contingencies

### Restructuring Provision

During 2017, the Company recorded total restructuring charges of \$13.2 million in relation to its expense savings initiative, Project EXPO. This restructuring initiative was intended to result in cost savings while positioning the Company to meet its strategic goals. These measures included organizational review, process redesign and premise optimization. The restructuring charges recorded relate primarily to employee severance and other related costs and were included in salaries and benefits. The remaining restructuring charges were included in premises and other operating expenses. The Company completed Project EXPO in 2017. The balance of the restructuring provision at December 31, 2017 was \$4.8 million. During 2018, \$2.1 million was utilized (2017 – \$8.4 million). In addition, the Company reversed \$1.8 million of the restructuring provision in 2018 due to a change in estimates and recorded a corresponding credit to salaries and benefits. The remaining balance at December 31, 2018 was \$0.9 million.

### Contingencies

In the ordinary course of business, the Company and its subsidiaries are involved in various legal actions. The Company establishes legal provisions when it becomes probable that the Company will incur a loss and the amount can be reliably estimated.

In management's opinion, based on its current knowledge and after consultation with counsel, the ultimate disposition of these actions, individually or in the aggregate, will not have a material adverse effect on the consolidated financial position of the Company. However, as there are uncertainties inherent in litigation advice, there is a possibility that the ultimate resolution of these actions may be material to the Company's consolidated results of operations for any particular reporting period.

The following is a description of the Company's material legal actions.

### **Claims by Shareholders Who Opted Out of Securities Class Action Settlement Related to Disclosure**

The Company has been served with three claims by shareholders who opted out of the securities class action settlement previously disclosed in Q3 2017. Together these claims are advanced on behalf of shareholders holding 1,717,400 shares out of 1,717,600 shares that were opted out of the class action settlement.

The claim filed on behalf of West Face Long Term Opportunities Global Master LP ("West Face"), a Cayman Islands limited partnership is based on allegations of misrepresentation and seeks \$70 million in damages. West Face alleges that it built a significant short position in Home Capital in the spring and summer of 2013. It then reversed its investment strategy, covering its short position between the fall of 2013 and the spring of 2015.

The claim filed by Roland Keiper and Brian Chapman is based on allegations of common law and statutory misrepresentation and oppressive conduct and seeks \$2 million in damages.

The claim filed by Marc Cohodes is based on allegations of misrepresentation and oppressive conduct and seeks \$4 million in damages. Mr. Cohodes claims to have altered his investment strategy, covering at least some of his short position between March and June of 2015.

Management's current assessment is that it has good and valid defences to all three claims and the Company intends to fully defend its conduct. The costs incurred by the Company in the defence of each proceeding are expensed in the period in which they are incurred.

### **Putative Class Action Related to Consumer HVAC Equipment Financing**

A claim has been filed in the Ontario Superior Court of Justice against Home Trust, and co-defendants MDG Newmarket Inc. doing business as Ontario Energy Group (OEG) and Eugene Farber. In that matter Home Trust is a defendant in a putative class action brought on behalf of persons who purchased consumer HVAC equipment financed by Home Trust from OEG, an entity arms-length from Home Trust. In May 2016, Home Trust ceased purchasing income streams arising out of contracts with new customers of OEG and in September 2016 provided notice that it would no longer accept any rental agreement from OEG under the income-stream purchase program. In May of 2017, the plaintiff served motions for certification and summary judgment, which are pending. Home Trust considers that it has good defences to the action.

## **18. Derivative Financial Instruments and Hedging Activities**

The Company uses interest rate swaps and bond forward contracts to hedge exposures related to interest rate risk to minimize volatility in earnings. Total return swaps are used to hedge the Company's exposure to changes in its share price related to its RSU liability. When a hedging derivative functions effectively, gains, losses, revenues or expenses of the hedging derivative will offset the gains, losses, revenues or expenses of the hedged item. To qualify for hedge accounting treatment, the hedging relationship is formally designated and documented at its inception. The documentation describes the particular risk management objective and strategy for the hedge and the specific asset, liability or cash flow being hedged and how the effectiveness of the hedge is assessed and the ineffectiveness is measured. Changes in the fair value of the derivative instruments must be highly effective at offsetting either the changes in the fair value of the on-balance sheet asset or liability being hedged or the changes in the amount of future cash flows.

Fair value represents point-in-time estimates that may change in subsequent reporting periods due to market conditions or other factors. The fair value of derivatives is determined from swap curves adjusted for credit risks. Swap curves are obtained directly from market sources or calculated from market prices.

Hedge effectiveness is assessed at the inception of the hedge and on an ongoing basis, retrospectively and prospectively, over the life of the hedge. Any ineffectiveness in the hedging relationship is recognized immediately through non-interest income in net realized and unrealized gain or loss on derivatives. The main sources of ineffectiveness can be attributed to differences between hedging instruments and hedged items such as differences in discounting factors when derivatives are discounted using indexed swap curves, and mismatch in critical terms such as tenor and timing of cashflows between hedging instrument and hedged items.

### **Cash Flow Hedging Relationships**

The Company uses bond forward contracts to hedge the exposure to movements in interest rates between the time that the Company determines that it will likely incur liabilities pursuant to asset securitization and the time the securitization transaction is complete and the liabilities are incurred. The intent is to use the bond forwards to manage the change in cash flows of the future interest payments on the anticipated secured borrowings through asset securitization. Changes in the fair value of the derivative instrument that occur before the liability is incurred are recorded in AOCI. The fair value changes recorded in AOCI are reclassified into net interest income over the term of the hedged liability.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(unless otherwise stated, all amounts are in Canadian dollars)

The Company uses total return swaps to hedge the variability in cash flows associated with forecasted future obligations to eligible employees on vesting of RSUs attributable to changes in the Company's stock price. Over time, redemptions and cancellations of the RSUs may result in unhedged derivative positions. These unhedged derivatives are not designated as hedges for accounting purposes, and as such the changes in fair value do not flow through AOCI and compensation expense. The changes in fair value of such derivatives flow directly to the consolidated statements of income within derivative gain or loss. Net gains of \$2.1 million (2017 – net losses of \$528 thousand) were recorded in income through net realized and unrealized gain or loss on derivatives.

For cash flow hedges, the Company uses the hypothetical derivative having terms that identically match the critical terms of the hedged item as the proxy for measuring the change in fair value or cash flows of the hedged item.

The following table presents the effects of cash flow hedges on the consolidated statements of income and the consolidated statements of comprehensive income:

thousands of Canadian dollars		For the year ended December 31, 2018					
	Change in value of hedged items for ineffectiveness measurement	Change in fair value of hedging instruments for ineffectiveness measurement	Hedge ineffectiveness	Hedging gains (losses) recognized in OCI (pre-tax basis)	Amount reclassified from AOCI to net income (pre-tax basis)	Effect on OCI (pre-tax basis)	
Liabilities							
Interest rate risk	\$ (1,417)	\$ 1,417	\$ —	\$ (1,417)	\$ 729	\$ (688)	
Equity price risk	139	(139)	—	139	(19)	120	
Total cash flow hedges	\$ (1,278)	\$ 1,278	\$ —	\$ (1,278)	\$ 710	\$ (568)	
For the year ended							
December 31, 2017	\$ (721)	\$ 721	\$ —	\$ (721)	\$ 1,120	\$ 399	

The following table provides a reconciliation of AOCI related to cash flow hedges on a pre-tax basis:

thousands of Canadian dollars		For the year ended December 31, 2018				
	AOCI at the beginning of the year	Other comprehensive income (loss)	AOCI at the end of the year	AOCI on designated hedges	AOCI on de-designated hedges	
Liabilities						
Interest rate risk	\$ (1,466)	\$ (688)	\$ (2,154)	\$ (166)	\$ (1,988)	
Equity price risk	(140)	120	(20)	(117)	97	
Total cash flow hedges	\$ (1,606)	\$ (568)	\$ (2,174)	\$ (283)	\$ (1,891)	

### Fair Value Hedging Relationships

The Company uses interest rate swaps to hedge changes in the fair value of fixed-rate assets and liabilities, which are associated with changes in market interest rates. Fair value hedges include hedges of fixed-rate liabilities, which include deposits, deposit notes and securitization liabilities. The Company assesses and measures the hedge effectiveness of fair value hedges based on the change in the fair value of the derivative hedging instrument relative to the change in the fair value of the hedged item attributable to benchmark interest rate risk.

The following table presents the effects of fair value hedges on the consolidated balance sheets and the consolidated statements of income:

thousands of Canadian dollars		For the year ended or as at December 31, 2018				
	Change in value of hedged items for ineffectiveness measurement	Change in fair value of hedging instruments for ineffectiveness measurement	Hedge ineffectiveness gain (loss)	Carrying amounts for hedged items	Accumulated amount of fair value hedge adjustments on hedged items	
Liabilities						
Interest rate risk						
Deposits	\$ (14,371)	\$ 14,663	\$ 292	\$ 3,761,562	\$ (23,619)	
Securitization liabilities	379	(1,081)	(702)	60,267	528	
Total liabilities	\$ (13,992)	\$ 13,582	\$ (410)	\$ 3,821,829	\$ (23,091)	
For the year ended December 31, 2017	\$ 62,493	\$ (63,975)	\$ (1,482)	\$ 3,900,659	\$ (34,611)	

## Other Derivative Gains and Losses

The Company enters into bond forwards to economically hedge interest rate risk on loans held for securitization. Realized and unrealized gains or losses on these derivatives are included in securitization income on the consolidated statements of income. Please see Note 6 for more information.

The following table presents the derivative financial instruments outstanding as at December 31, 2018 distinguishing between those designated in qualifying hedging relationships and those that are not in qualifying hedging relationships:

thousands of Canadian dollars, except average rate/price

As at December 31, 2018

Term (years)	Notional Amount	Average Rate on Interest Rate Swaps	Current Replacement Cost <sup>1</sup>	Credit Equivalent Amount <sup>1</sup>	Risk-weighted Balance <sup>1</sup>	Derivative Asset	Derivative Liability	Net Fair Market Value
<b>Derivatives in qualifying hedging relationships</b>								
Interest rate risk								
Interest rate swaps								
designated in fair value hedges <sup>2</sup>								
< 1 year	\$ 1,252,000	1.70%	\$ —	\$ —	\$ —	\$ —	(5,090)\$	(5,090)
1 to 5 years	2,669,000	1.89%	8,886	22,229	10,984	8,886	(28,014)	(19,128)
	3,921,000	1.83%	8,886	22,229	10,984	8,886	(33,104)	(24,218)
Bond forwards designated as cash flow hedges <sup>3</sup>								
1 to 5 years	25,000	N/A	—	125	63	—	(166)	(166)
	25,000	N/A	—	125	63	—	(166)	(166)
Total interest rate contracts	3,946,000		8,886	22,354	11,047	8,886	(33,270)	(24,384)
Equity price risk								
Total return swaps designated as cash flow hedges								
< 1 year	585	N/A	15	50	25	15	(155)	(140)
1 to 5 years	425	N/A	24	58	29	24	—	24
	1,010	N/A	39	108	54	39	(155)	(116)
Total derivatives in qualifying hedging relationships	3,947,010		8,925	22,462	11,101	8,925	(33,425)	(24,500)
<b>Derivatives not in qualifying hedging relationships</b>								
Bond forwards <sup>3</sup>								
1 to 5 years	6,800	N/A	—	34	34	—	(58)	(58)
> 5 years	110,900	N/A	—	1,664	1,664	—	(2,492)	(2,492)
	117,700	N/A	—	1,698	1,698	—	(2,550)	(2,550)
Total	\$ 4,064,710		\$ 8,925	\$ 24,160	\$ 12,799	\$ 8,925	\$ (35,975)	\$ (27,050)

<sup>1</sup> The values are calculated based on the capital adequacy requirements required by OSFI.

<sup>2</sup> Average rate for interest rate swaps represents the weighted average received fixed rate.

<sup>3</sup> The term of the bond forward contract is based on the term of the underlying bonds.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(unless otherwise stated, all amounts are in Canadian dollars)

As at December 31, 2017, the outstanding swaps and bond forward contract positions were as follows:

thousands of Canadian dollars		As at December 31, 2017					
Term (years)	Notional Amount	Current Replacement Cost <sup>1</sup>	Credit Equivalent Amount <sup>1</sup>	Risk-weighted Balance <sup>1</sup>	Derivative Asset	Derivative Liability	Net Fair Market Value
Swaps designated as accounting hedges							
< 1 year	\$ 739,206	\$ 2,584	\$ 2,615	\$ 523	\$ 2,584	\$ (303)	2,281
1 to 5 years	3,231,323	3,530	19,710	9,641	3,530	(38,425)	(34,895)
	3,970,529	6,114	22,325	10,164	6,114	(38,728)	(32,614)
Bond forwards not designated as accounting hedges <sup>2</sup>							
1 to 5 years	28,600	224	367	367	224	—	224
> 5 years	130,400	987	2,943	2,943	987	—	987
	159,000	1,211	3,310	3,310	1,211	—	1,211
<b>Total</b>	<b>\$ 4,129,529</b>	<b>\$ 7,325</b>	<b>\$ 25,635</b>	<b>\$ 13,474</b>	<b>\$ 7,325</b>	<b>\$ (38,728)</b>	<b>(31,403)</b>

<sup>1</sup> The values are calculated based on the capital adequacy requirements required by OSFI.

<sup>2</sup> The term of the bond forward contracts is based on the term of the underlying bonds.

The notional amount is not recorded as an asset or liability as it represents the face amount of the contract to which the rate or price is applied in order to calculate the amount of cash exchanged. Notional amounts do not represent the potential gain or loss associated with market risk and are not indicative of the credit risk associated with the derivatives.

### Derivative-Related Risks

The potential for derivatives to increase or decrease in value as a result of changes in relevant factors, such as interest rate, equity or index changes, is referred to as market risk. Credit risk on derivatives, also known as counterparty credit risk, is the risk of a financial loss occurring as a result of the failure of a counterparty to meet its obligation to the Company. These risks are actively managed by the Company and are monitored independently by the Enterprise Risk Management group.



## 19. Current and Non-Current Assets and Liabilities

The following table presents an analysis of each asset and liability line item by amounts, including prepayment assumptions, expected to be recovered or settled within one year or after one year as at December 31, 2018 and 2017.

thousands of Canadian dollars	As at December 31, 2018			As at December 31, 2017		
	Within 1 Year	After 1 Year	Total	Within 1 Year	After 1 Year	Total
<b>Assets</b>						
Cash and cash equivalents	\$ 665,947	\$ —	\$ 665,947	\$ 1,336,138	\$ —	\$ 1,336,138
Securities	4,905	381,428	386,333	3,157	329,311	332,468
Loans held for sale	130,351	—	130,351	165,947	—	165,947
Securitized mortgages	833,220	1,967,403	2,800,623	841,273	2,151,977	2,993,250
Non-securitized mortgages and loans	9,948,721	3,515,043	13,463,764	9,113,500	2,796,939	11,910,439
Allowance for credit losses	(30,681)	(21,010)	(51,691)	(24,904)	(13,871)	(38,775)
Restricted assets	309,205	—	309,205	437,011	—	437,011
Derivative assets	15	8,910	8,925	2,584	4,741	7,325
Other assets	221,877	117,110	338,987	220,811	115,959	336,770
Deferred tax assets	—	3,489	3,489	—	9,577	9,577
Goodwill and intangible assets	—	85,756	85,756	—	100,993	100,993
<b>Total assets</b>	<b>\$ 12,083,560</b>	<b>\$ 6,058,129</b>	<b>\$ 18,141,689</b>	<b>\$ 12,095,517</b>	<b>\$ 5,495,626</b>	<b>\$ 17,591,143</b>
<b>Liabilities</b>						
Deposits	\$ 6,306,335	\$ 6,670,755	\$ 12,977,090	\$ 6,264,787	\$ 5,905,667	\$ 12,170,454
CMHC-sponsored mortgage-backed security liabilities	382,799	1,190,417	1,573,216	321,667	1,240,485	1,562,152
CMHC-sponsored Canada Mortgage Bond liabilities	—	1,239,331	1,239,331	231,886	1,241,432	1,473,318
Bank-sponsored securitization conduit liabilities	40,545	6,234	46,779	102,718	39,561	142,279
Credit facilities	261,506	—	261,506	—	—	—
Derivative liabilities	5,245	30,730	35,975	303	38,425	38,728
Other liabilities	317,166	21,178	338,344	339,553	20,924	360,477
Deferred tax liabilities	—	28,838	28,838	—	30,230	30,230
<b>Total liabilities</b>	<b>\$ 7,313,596</b>	<b>\$ 9,187,483</b>	<b>\$ 16,501,079</b>	<b>\$ 7,260,914</b>	<b>\$ 8,516,724</b>	<b>\$ 15,777,638</b>
<b>Net</b>	<b>\$ 4,769,964</b>	<b>\$ (3,129,354)</b>	<b>\$ 1,640,610</b>	<b>\$ 4,834,603</b>	<b>\$ (3,021,098)</b>	<b>\$ 1,813,505</b>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(unless otherwise stated, all amounts are in Canadian dollars)

### 20. Fair Value of Financial Instruments

The amounts set out in the following tables represent the fair values of the Company's financial instruments. The valuation methods and assumptions are described below.

The estimated fair value amounts approximate the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants that are under no compulsion to act at the consolidated balance sheet date in the principal or most advantageous market that is accessible to the Company. For financial instruments carried at fair value that lack an active market, the Company applies present value and valuation techniques that use, to the greatest extent possible, observable market inputs. Because of the estimation process and the need to use judgement, the aggregate fair value amounts should not be interpreted as being necessarily realizable in an immediate settlement of the instruments.

The Company uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

Level 1: Significant inputs are quoted (unadjusted) prices in active markets for identical assets or liabilities. This level includes cash and cash equivalents, equity securities traded on the Toronto Stock Exchange and quoted corporate debt instruments.

Level 2: Significant inputs are observable for the asset or liability, either directly or indirectly, and are not quoted prices included within Level 1. This level includes government-backed debt instruments, loans held for sale, interest rate swaps, total return swaps, bond forwards and certain corporate debt instruments.

Level 3: Significant inputs are unobservable for the asset or liability. This level includes retained interest, certain corporate debt instruments, securitized and non-securitized mortgages and loans, securitization receivables and liabilities, other assets and liabilities, and deposits and liabilities arising from credit facilities.

The following table presents the fair value of financial instruments across the levels of the fair value hierarchy. Balances for 2018 are presented according to their classification under IFRS 9. Balances for 2017 are presented according to their classification under IAS 39.

	As at December 31, 2018				
	Level 1	Level 2	Level 3	Fair Value	Carrying Value
<b>Financial assets at FVTPL</b>					
Cash and cash equivalents	\$ 665,947	\$ —	\$ —	\$ 665,947	\$ 665,947
Loans held for sale	—	130,351	—	130,351	130,351
Derivative assets	—	8,925	—	8,925	8,925
Restricted assets	262,215	—	—	262,215	262,215
<b>Total financial assets at FVTPL</b>	<b>928,162</b>	<b>139,276</b>	<b>—</b>	<b>1,067,438</b>	<b>1,067,438</b>
<b>Financial assets at FVOCI</b>					
Debt securities	—	359,981	—	359,981	359,981
Equity securities (designated at FVOCI)	26,352	—	—	26,352	26,352
Retained interest owned	—	—	108,445	108,445	108,445
<b>Total financial assets at FVOCI</b>	<b>26,352</b>	<b>359,981</b>	<b>108,445</b>	<b>494,778</b>	<b>494,778</b>
<b>Financial assets at amortized cost</b>					
Securitized mortgages	—	—	2,771,406	2,771,406	2,799,931
Non-securitized mortgages and loans	—	—	13,338,215	13,338,215	13,412,765
Restricted assets	—	46,990	—	46,990	46,990
Securitization receivables	—	—	56,706	56,706	56,706
Other	—	—	92,751	92,751	92,751
<b>Total financial assets at amortized cost</b>	<b>—</b>	<b>46,990</b>	<b>16,259,078</b>	<b>16,306,068</b>	<b>16,409,143</b>
<b>Total</b>	<b>\$ 954,514</b>	<b>\$ 546,247</b>	<b>\$16,367,523</b>	<b>\$17,868,284</b>	<b>\$17,971,359</b>
<b>Financial liabilities at amortized cost</b>					
Deposits	\$ —	\$ —	\$ 13,003,402	\$13,003,402	\$12,977,090
Securitization liabilities	—	—	2,859,905	2,859,905	2,859,326
Other	—	—	599,850	599,850	599,850
<b>Total financial liabilities at amortized cost</b>	<b>—</b>	<b>—</b>	<b>16,463,157</b>	<b>16,463,157</b>	<b>16,436,266</b>
<b>Financial liabilities at FVTPL</b>					
Derivative liabilities	—	35,975	—	35,975	35,975
<b>Total</b>	<b>\$ —</b>	<b>\$ 35,975</b>	<b>\$16,463,157</b>	<b>\$16,499,132</b>	<b>\$16,472,241</b>

thousands of Canadian dollars

As at December 31, 2017

	Level 1	Level 2	Level 3	Fair Value	Carrying Value
<b>Financial assets held for trading</b>					
Cash and cash equivalents	\$ 1,336,138	\$ —	\$ —	\$ 1,336,138	\$ 1,336,138
Loans held for sale	—	165,947	—	165,947	165,947
Derivative assets	—	7,325	—	7,325	7,325
Restricted assets	254,134	—	—	254,134	254,134
Total financial assets held for trading	1,590,272	173,272	—	1,763,544	1,763,544
<b>Financial assets available for sale</b>					
Debt securities	—	300,566	968	301,534	301,534
Equity securities	30,934	—	—	30,934	30,934
Restricted assets	—	182,877	—	182,877	182,877
Retained interest owned	—	—	105,528	105,528	105,528
Total financial assets available for sale	30,934	483,443	106,496	620,873	620,873
<b>Loans and receivables</b>					
Securitized mortgages	—	—	3,005,970	3,005,970	2,993,250
Non-securitized mortgages and loans	—	—	11,958,552	11,958,552	11,871,664
Securitization receivables	—	—	81,046	81,046	81,046
Other	—	—	62,991	62,991	62,991
Total loans and receivables	—	—	15,108,559	15,108,559	15,008,951
Total	\$ 1,621,206	\$ 656,715	\$ 15,215,055	\$ 17,492,976	\$ 17,393,368
<b>Financial liabilities at amortized cost</b>					
Deposits	\$ —	\$ —	\$ 12,432,343	\$ 12,432,343	\$ 12,170,454
Securitization liabilities	—	—	3,174,786	3,174,786	3,177,749
Other	—	—	360,477	360,477	360,477
Total financial liabilities at amortized cost	—	—	15,967,606	15,967,606	15,708,680
<b>Financial liabilities at fair value</b>					
Derivative liabilities	—	38,728	—	38,728	38,728
Total	\$ —	\$ 38,728	\$ 15,967,606	\$ 16,006,334	\$ 15,747,408

The Company did not transfer any financial instrument from Level 1 or Level 2 to Level 3 of the fair value hierarchy during the years ended December 31, 2018 or December 31, 2017.

The following methods and assumptions were used to estimate the fair values of financial instruments:

- > The fair value of cash and cash equivalents, restricted assets, other assets and other liabilities approximate their carrying values due to their short-term nature.
- > Debt and equity securities are valued based on the quoted bid price. Third-party MBS are fair valued using average dealer quoted prices. The fair value of the acquired residual interests of underlying securitized insured fixed-rate residential mortgages was calculated by modelling the future net cash flows. The cash flows are calculated as the difference between the expected cash flow from the underlying mortgages and payment to NHA MBS holders, discounted at the appropriate rate of return.
- > Fair value of loans held for sale, all of which are insured, is determined by discounting the expected future cash flows of the loans at current market rates imputed by the realized sale of loans with similar terms.
- > The fair value of the retained interest is determined by discounting the expected future cash flows using the current MBS spread over Government of Canada bonds imputed from recent sale transactions.
- > The fair value of securitization receivables is determined by discounting the expected future cash flows using current interest rate swap rates.
- > Securitized and non-securitized mortgages and loans are carried at amortized cost in the financial statements. For fair value disclosures, the fair value is estimated by discounting the expected future cash flows of the loans, adjusting for credit risk and prepayment assumptions at current market rates for offered loans with similar terms.
- > Fair value of derivative financial instruments is calculated as described in Note 18.
- > Retail deposits are not transferable by the deposit holders. In the absence of such transfer transactions, fair value of deposits is determined by discounting the expected future cash flows of the deposits at offered rates for deposits with similar terms. The fair value of the institutional deposit notes was determined using current rates of Government of Canada bonds, plus a spread. The rates reflect the credit risks of similar instruments.
- > Fair value of securitization liabilities is determined using their correspondent current market rates including market rates for MBS, CMB and the interest rate swap curve.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(unless otherwise stated, all amounts are in Canadian dollars)

### 21. Related Party Transactions

IFRS considers key management personnel to be related parties. Key management personnel are those persons having authority and responsibility for planning, directing, and controlling the activities of the Company, directly or indirectly. The Company considers certain of its officers and Directors to be key management personnel. Compensation of key management personnel of the Company is as follows:

thousands of Canadian dollars	2018	2017
Short-term employee benefits <sup>1</sup>	\$ 5,601	\$ 7,057
Share-based payment <sup>2</sup>	3,484	1,275
Other long-term benefits <sup>3</sup>	253	183
	<b>\$ 9,338</b>	<b>\$ 8,515</b>

<sup>1</sup> Short-term employee benefits include salary, benefits and accrued cash bonuses for officers and fees for non-executive Directors including fees elected to be received in the form of DSUs.

<sup>2</sup> Share-based payment includes fair value of stock options, RSUs and PSUs granted during the year to officers.

<sup>3</sup> Other long-term benefits include the Company's contribution to officers' Employee Share Purchase Plan and Employee Retirement Savings Plan and other long-term benefits.

### 22. Disposal of PSiGate and Prepaid Card Business

On February 1, 2018, the Company completed the previously announced sale of the Company's payment processing and prepaid card business including its Payment Services Interactive Gateway subsidiaries. As part of the agreement, Home Capital and Home Trust Company entered into a transition services agreement and will continue to provide services for certain clients for a limited time, after which the Company will have completely exited this business line. The Company received net proceeds of \$310 thousand on the sale and recognized a resulting gain of \$950 thousand included in non-interest income. The sale did not have a material impact on the Company's consolidated balance sheet.

### 23. Risk Management

The Company is exposed to various types of risk owing to the nature of the business activities it carries on. Types of risk to which the Company is subject include capital adequacy, credit, market, liquidity and funding, operational, compliance, strategic and reputational risk. The Company has adopted enterprise risk management (ERM) as a discipline for managing risk. The Company's ERM structure is supported by a governance framework that includes policies, management standards, guidelines, procedures and limits appropriate to each business activity. The policies are reviewed and approved annually by the Board.

A description of the Company's risk management policies and procedures is included in the shaded text of the Risk Management section of the Management's Discussion and Analysis included in this report. Significant exposures to credit and liquidity risks are described in Notes 4, 5 and 18.

### 24. Subsequent Events

The Company implemented an NCIB on January 2, 2019, which allows it to purchase up to 4,753,517 of its common shares prior to January 1, 2020. During 2019, the Company executed a portion of the NCIB through an automatic purchase plan with a broker, repurchasing 735,050 shares at market prices.

## CORPORATE DIRECTORY AND SHAREHOLDER INFORMATION

### HOME CAPITAL GROUP INC.

145 King Street West  
Suite 2300  
Toronto, Ontario M5H 1J8

### Auditors

Ernst & Young LLP  
Toronto, Ontario

### Transfer Agent

Computershare Investor  
Services Inc.  
100 University Avenue  
Toronto, Ontario M5J 2Y1  
Tel: 800-564-6253

### Capital Stock

As at December 31, 2018  
there were 62,064,531  
Common Shares outstanding

### Stock Listing

Toronto Stock Exchange  
Ticker Symbol: HCG

### Options Listing

Montreal Stock Exchange  
Ticker Symbol: HCG

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## BRANCHES

### Toronto

145 King Street West  
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Tel: 416-360-4663  
800-990-7881  
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888-470-2092

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Calgary, Alberta T2R 0A8  
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866-235-3081  
Fax: 403-244-6542  
866-544-3081

### Vancouver

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Suite 1288  
Vancouver, British Columbia V6C 1S4  
Tel: 604-484-4663  
866-235-3080  
Fax: 604-484-4664  
866-564-3524

### Halifax

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Suite 101  
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888-306-2421  
Fax: 902-422-8891  
888-306-2435

### Montreal

2020 Boulevard Robert-Bourassa  
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Montreal, Quebec H3A 2A5  
Tel: 514-843-0129  
866-542-0129  
Fax: 514-843-7620  
866-620-7620

### Winnipeg

201 Portage Avenue  
Suite 830  
Winnipeg, Manitoba R3B 3K6  
Tel: 204-220-3400  
Fax: 204-942-1638

### For Shareholder Information, Please Contact:

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*General Counsel and  
Corporate Secretary*  
Home Capital Group Inc.  
145 King Street West  
Suite 2300  
Toronto, Ontario M5H 1J8  
Tel: 416-360-4663  
Fax: 416-363-7611

### Websites

Home Capital Group Inc.  
[www.homecapital.com](http://www.homecapital.com)  
Home Trust Company  
[www.hometruster.ca](http://www.hometruster.ca)

### Investor Information Service

Home Capital Group Inc. has established  
an e-mail investor information service.  
Sign up at [www.homecapital.com](http://www.homecapital.com)  
to receive quarterly reports, press releases,  
the annual report, the management  
information circular, and other information  
pertaining to the Company.

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## OAKEN FINANCIAL STORES

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