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K S L R E S P E C T S Z G V H G D
R E L E N T L E S S D G F M T H M

EQUITABLE

CANADA'S CHALLENGER BANKTM

Fourth Quarter Report 2019

For the three and twelve months
ended December 31, 2019



TSX.EQB | EQB.PR.C

EQUITABLE GROUP INC.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

For the three months and year ended December 31, 2019

Management's Discussion and Analysis ("MD&A") is provided to enable readers to assess the financial position and the results of the consolidated operations of Equitable Group Inc. ("Equitable" or the "Company") for the three months ("quarter") and year ended December 31, 2019. This MD&A should be read in conjunction with the Company's unaudited interim consolidated financial statements for the fourth quarter (see Tables 23-25 in the section "Fourth Quarter Overview" of this report) and the audited consolidated financial statements and accompanying notes for the year ended December 31, 2019. All amounts are in Canadian dollars. This report, and the information provided herein, is dated as at February 24, 2020. The Company's continuous disclosure materials, including interim filings, annual MD&A and Consolidated Financial Statements, Annual Information Form, Notice of Annual Meeting of Shareholders and Proxy Circular are available on the Company's website at www.equitablebank.ca and on SEDAR at www.sedar.com.

Reporting Changes

Effective Q1 2019, we began reporting the financial results of our businesses based on two portfolios: Retail and Commercial. This reporting structure better aligns our assets with our customer segments and the way in which we manage the businesses. It is also more consistent with market practice. We have updated all historical figures contained in our annual MD&A and consolidated financial statements to conform to this new reporting format. Please refer to Note 2(f) to the 2019 annual consolidated financial statements for further details.

Adoption of IFRS 16

Effective January 1, 2019, the Company adopted IFRS 16 Leases ("IFRS 16") issued by the International Accounting Standards Board ("IASB"), which replaced IAS 17 Leases ("IAS 17"). IFRS 16 introduces a single, on-balance sheet accounting model for leases that requires recognition of a Right-of-Use ("ROU") asset and a corresponding lease liability. The Company used the modified retrospective approach and recognized a \$0.8 million opening retained earnings adjustment on January 1, 2019, resulting in a \$0.05 reduction in our book value per common share upon adoption. Please refer to Note 3 to the annual consolidated financial statements for a summary of the Company's accounting policies as it relates to IFRS 16. We did not restate the comparative periods, as permitted by the standard. Therefore, current year period disclosures are not directly comparable to prior year period disclosures, although the overall impact is deemed immaterial.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

Statements made by the Company in the sections of this report including those entitled "Business Profile and Objectives", "2019 Highlights", "Business Outlook", "Credit Quality and Allowance for Credit Losses", "Liquidity Investments and Equity Securities", "Deposits", "Capital Management – Equitable Bank", "Fourth Quarter Overview", "Risk Management", in other filings with Canadian securities regulators and in other communications include forward-looking statements within the meaning of applicable securities laws ("forward-looking statements"). These statements include, but are not limited to, statements about the Company's objectives, strategies and initiatives, financial performance expectations and other statements made herein, whether with respect to the Company's businesses or the Canadian economy. Generally, forward-looking statements can be identified by the use of forward-looking terminology such as "plans", "expects" or "does not expect", "is expected", "budget", "scheduled", "planned", "estimates", "forecasts", "intends", "anticipates" or "does not anticipate", or "believes", or variations of such words and phrases which state that certain actions, events or results "may", "could", "would", "should", "might" or "will be taken", "occur", "be achieved", or other similar expressions of future or conditional verbs.

Forward-looking statements are subject to known and unknown risks, uncertainties and other factors that may cause actual results, level of activity, closing of transactions, performance or achievements of the Company to be materially different from those expressed or implied by such forward-looking statements, including but not limited to risks related to capital markets and additional funding requirements, fluctuating interest rates and general economic conditions, legislative and regulatory developments, changes in accounting standards, the nature of our customers and rates of default, and competition as well as those factors discussed under the heading “Risk Management” herein and in the Company's documents filed on SEDAR at www.sedar.com.

All material assumptions used in making forward-looking statements are based on management's knowledge of current business conditions and expectations of future business conditions and trends, including their knowledge of the current credit, interest rate, and liquidity conditions affecting the Company and the Canadian economy. Although the Company believes the assumptions used to make such statements are reasonable at this time and has attempted to identify in its continuous disclosure documents important factors that could cause actual results to differ materially from those contained in forward-looking statements, there may be other factors that cause results not to be as anticipated, estimated or intended. Certain material assumptions are applied by the Company in making forward-looking statements, including without limitation, assumptions regarding its continued ability to fund its loan business, a continuation of the current level of economic uncertainty that affects real estate market conditions, continued acceptance of its products in the marketplace, as well as no material changes in its operating cost structure and the current tax regime. There can be no assurance that such statements will prove to be accurate, as actual results and future events could differ materially from those anticipated in such statements. Accordingly, readers should not place undue reliance on forward-looking statements. The Company does not undertake to update any forward-looking statements that are contained herein, except in accordance with applicable securities laws.

BUSINESS PROFILE AND OBJECTIVES

OVERVIEW

Equitable Group Inc. (TSX: EQB and EQB.PR.C) is a growing Canadian financial services business that operates through its wholly owned subsidiary, Equitable Bank (the “Bank”). Equitable Bank is a Schedule I Bank regulated by the Office of the Superintendent of Financial Institutions Canada (“OSFI”) with total Assets Under Management⁽¹⁾ (“AUM”) of over \$33 billion. The Bank serves retail and commercial customers across Canada with a range of savings and lending solutions, offered under the Equitable Bank, *EQ Bank*, and Equitable Trust brands. On January 1, 2019, Equitable Bank acquired Bennington Financial Corp. (“Bennington”), a Canadian equipment leasing company that finances a wide range of assets through the Bodkin and Equirex brands. Equitable is one of nine publicly traded banks that are members of the S&P/TSX Composite. Equitable is also a member of the S&P/TSX Dividend Aristocrats, S&P/TSX Small Cap, S&P Canada BMI, and MSCI Small Cap (Canada) indices. Measured by assets, Equitable Bank is the ninth largest independent Schedule I Bank in Canada.



⁽¹⁾ See Non-Generally Accepted Accounting Principles Financial Measures section of this MD&A.

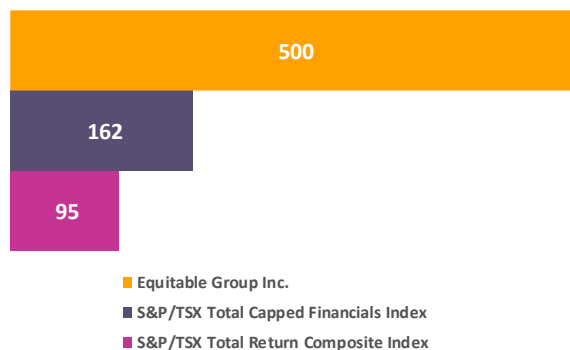
THE DECADE IN REVIEW

The past decade was a great period of value creation for Equitable. Our journey over the last ten years demonstrates what a group of highly engaged, service-oriented people dedicated to fulfilling a common vision can achieve. In the one decade alone, our company grew and diversified more than in the previous four decades combined. We have positioned Equitable to thrive as the banking industry continues to evolve.

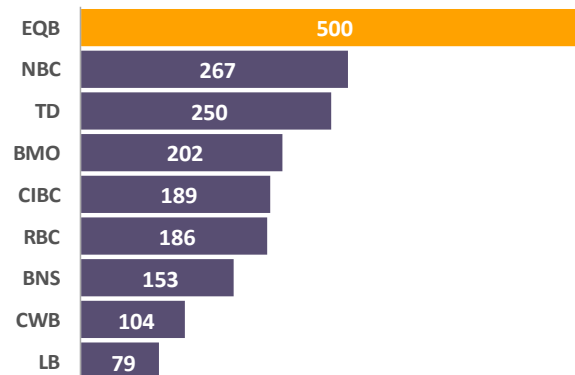
Since the beginning of 2010, we have grown from 183 skilled employees to nearly 900 strong. We converted The Equitable Trust Company to Equitable Bank, and from that have cemented our position as *Canada's Challenger Bank™*. This aspiration to help Canadians find better ways to bank led us to launch our *EQ Bank* digital platform in 2016. In four short years, *EQ Bank* has grown to service more than 95,000 Canadians. *EQ Bank* has been a key contributor to the diversification of our low-cost deposits and other funding sources over the decade. In addition to growing market share in our established lending businesses, we launched our decumulation platform in 2018, with the objective of providing valuable retirement management solutions such as reverse mortgage and Cash Surrender Value (“CSV”) Line of Credit products to a cohort of retired Canadians. Our acquisition of Bennington at the beginning of 2019 has broadened the Bank into the field of equipment financing. The performance of our company was also acknowledged through the inclusion of our stock in the S&P/TSX Composite Index in Q3 of 2019 – a great way to close a great decade.

Our strategy, and the hard work of our teams to execute on it, enabled Equitable to deliver a Total Shareholder Return⁽¹⁾ (“TSR”) of 500% since 2010, the highest of all the banks listed on the TSX.

Total Shareholder Return vs S&P/TSX Index, 2010–2019 [%]



Total Shareholder Return vs Peer Group, 2010–2019 [%]

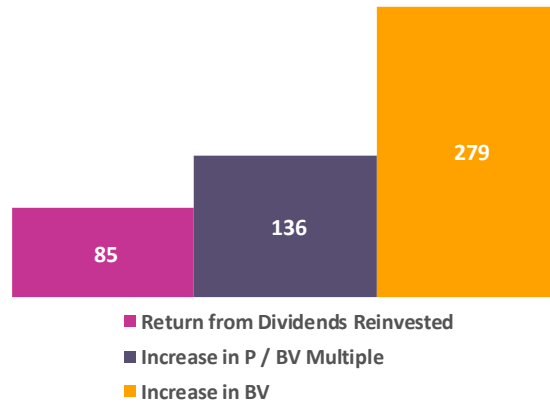


Our high relative return is evidence that we take a rigorous and disciplined approach to capital allocation to drive long-term shareholder returns. We invest significant time and attention to make decisions that optimize across the spectrum of capital allocation alternatives:

Book Value growth: We retained 89% of our earnings over the past decade and invested it at an average Adjusted Return on Shareholders’ Equity⁽¹⁾ (“ROE”) of 16.9%. That ROE was 1.1% higher than the average ROE of the other eight banks in the TSX Composite and more consistent throughout the period. The volatility of our returns, as measured by the standard deviation of Equitable’s ROE, was 65% of the Canadian bank average. As a result, we grew Equitable’s book value per common share⁽¹⁾ by an average rate of 14% per year from the beginning of 2010 through to the end of 2019.

⁽¹⁾ See Non-Generally Accepted Accounting Principles Financial Measures section of this MD&A.

**Total Shareholder Return Drivers,
2010–2019 [%]**

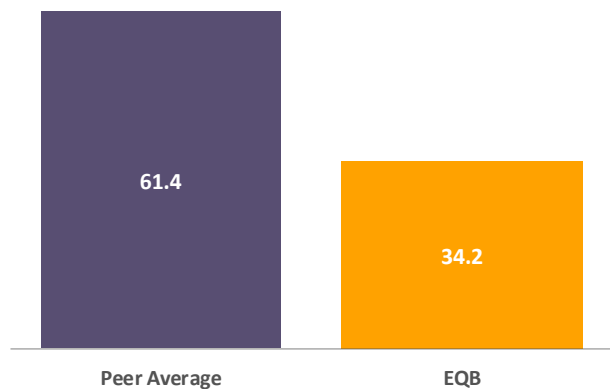


Earnings growth: As book value has increased, we have preserved our consistently high ROE by growing our earnings in parallel. Our Adjusted Net Income⁽¹⁾ in the fourth quarter of 2019 was greater than for the full year 2010 – and we achieved this growth while operating within our strict risk appetite. Equitable’s diluted EPS increased from \$3.48 in 2010 to \$11.97 in 2019 for an average annual growth rate of 14%. That performance compares favourably to the average 9% growth posted by other banks in the TSX Composite.

Our branchless operating model has supported our earnings growth; we are the most efficient of all the publicly traded banks. Our Adjusted Efficiency Ratio⁽¹⁾ was over 27 percentage points better than the average of the other banks over the past decade.

We serve customers through brokers and directly through digital platforms, and as a result do not have the high fixed cost branch networks that burden other banks in Canada and around the world. In addition, the modern technology stack that supports our digital platform is low cost, agile, and free of the significant technical debt that afflicts many other banks’ legacy platforms. Our low and flexible cost structure allows us to deliver greater value to our customers. We also have a highly productive workforce: our revenue per employee was \$1.4 million in 2019, nearly 2.4 times above the Canadian banking average of \$0.4 million.

**Average Adjusted Efficiency Ratio,
2010–2019 [%]**



Dividends: We increased our dividend 21 times over the decade, growing it by an average of 12% per year. Further, we announced plans to accelerate this growth and increase it by 20% to 25% per year in each of the next five years. In 2018, Equitable was added to the S&P/TSX Canadian Dividend Aristocrats Index. The Index is reserved for companies that have increased ordinary cash dividends every year for five years or maintained the same dividend for a maximum of two consecutive years within that five-year period.

⁽¹⁾ See Non-Generally Accepted Accounting Principles Financial Measures section of this MD&A.

What has not changed over the decade is our obsession with customer value and service. The mediums through which we reach our customers have changed, and we are leveraging technology more effectively in all of our business, but our commitment to going above and beyond is unwavering.

As we continue to execute on our strategic plan and follow our vision as *Canada's Challenger Bank™*, we remain focused on creating shareholder value. Our team cannot be complacent if we are to succeed over the next decade, particularly with the high degree of innovation and regulatory change happening in Canada. We take several important lessons with us as we begin 2020:

- **Risk management** – inclusive of reputational risk – is paramount in our industry. Our decisions should be guided not by short-term financial returns but primarily by a longer-term view that protects both our depositors and shareholders. We are determined to avoid the reputational and regulatory issues that many banking industry participants have faced around the globe.
- **Allocating capital** in order to optimize returns to our shareholders while prudently managing the Bank's risk profile is an essential part of the role of our senior leaders and Board of Directors (the "Board"). Capital management is part of our Board's strategic agenda every year and includes topics such as dividend policy and capital ratio targets. Effective capital allocation is a critical cause element of our industry-leading TSR over the past ten years. While we are committed to consistently increasing our dividend, retaining and reinvesting our earnings will remain our priority.
- **Capital deployment** is central to management's role. We invest significant time and attention to deploying capital profitably across our businesses, as well as to structuring and pricing individual loans, so that we achieve our ROE targets. In addition to our established residential and commercial businesses, new products lines such as reverse mortgages, CSV loans, and equipment leasing increase our options to sustain high risk-adjusted returns.
- **Quality service and a passion for customer value** are differentiating features for Equitable in Canadian banking. Our commitment to these values has allowed us to gain share in all of our businesses, and will continue to be a cornerstone of our approach going forward.
- Canadian consumers are willing to embrace **innovative ideas** that make banking better, such as *EQ Bank*. For example, *EQ Bank's* ground-breaking international money transfer service allows *EQ Bank* customers to send transparent and fast international money transfers that are up to eight times cheaper than those of other banks in Canada, with the ease of using their *EQ Bank Savings Plus Account*. The *EQ Bank Savings Plus Account* also reimagines banking by offering an everyday high interest rate plus the flexibility of a chequing account, with unlimited transactions, no everyday banking fees, no minimum balances, and more – all from one account. It is incumbent on us to continue fostering a company-wide culture of entrepreneurialism and an innovation mindset among all of our employees. We believe that this culture enables us to be more responsive and agile than the larger banks in our market. Equitable also intends to make meaningful investments to drive this innovation agenda ahead in the coming years.
- The **cost efficiency** of our branchless banking model is an important competitive advantage. It allows us to offer greater value to our customers, primarily by way of higher rates on their deposits. We are committed to operating leanly and maintaining the lowest efficiency ratio among Canadian banks.
- **Flawless execution** is as important as strategy. We will continue to invest in our capabilities to ensure that we have the right technology, people, and systems to execute on our vision for Equitable.

With our strong foundation, differentiated strategy and culture, and our learnings from the past ten years, we are well positioned and excited about the potential that the next decade holds for *Canada's Challenger Bank™*.

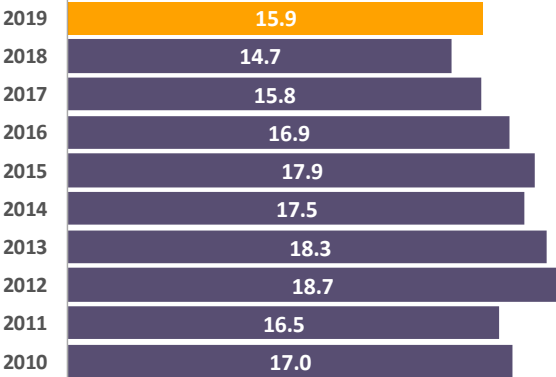
RESULTS

We have achieved steady earnings growth over the past ten years, culminating in all-time record net income in 2019. This performance was enabled by our disciplined approach to deploying capital, high asset growth, and low credit losses.

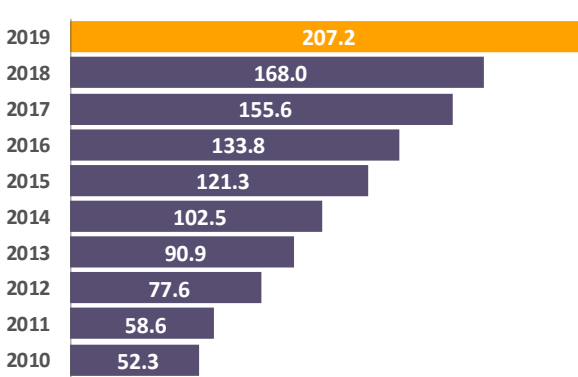
Consistent earnings growth helped Equitable to generate an average Adjusted ROE of 16.2% over the past five years and 16.9% over the past decade. Since 2017, ROE has still been high but lower than the Bank’s 10-year average due to the investments we have been making in key strategic initiatives and the costs associated with navigating through funding market disruptions in that year. Our medium-term objective is to maintain an ROE in the range of 15% to 17%.

In light of the business opportunities that our strategy creates, we have retained the vast majority of our earnings in order to build our capital base and to deploy it profitably. On the basis of this approach, we have grown Equitable’s book value per common share by an average rate of 15.2% over the past five-years and by 14.3% over the past ten years. At the same time, we have increased the Company’s dividend by an average rate of 12.4% since 2009, and announced plans to increase it by 20% to 25% per year through 2024.

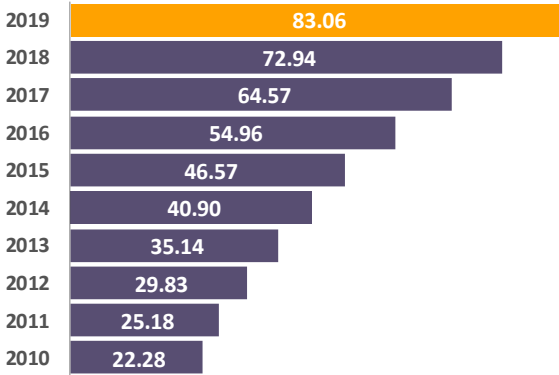
Adjusted ROE⁽¹⁾
[%]



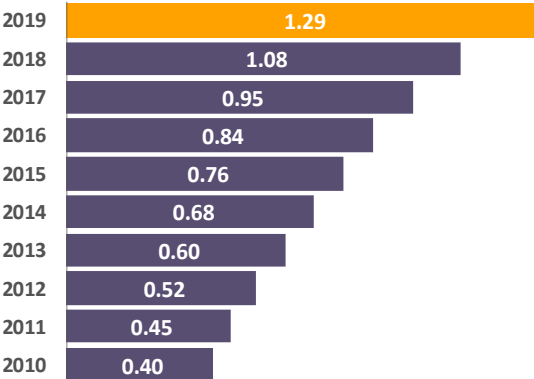
Adjusted Net Income Available to Common Shareholders⁽¹⁾
[\$ millions]



Book Value per Common Share
[\$]



Dividend per Common Share
[\$]



VISION AND STRATEGY – Canada’s Challenger Bank™

Equitable’s strategy is to provide exceptional service and clear value to select segments of Canadian consumers and businesses. We concentrate on segments of the market in which we can improve the banking experience or achieve a sustainable competitive advantage. As *Canada’s Challenger Bank™*, we rethink conventional approaches to banking, go above and beyond traditional banks in serving our customers, stay nimble so that we can act on new opportunities, and maintain focused, efficient service delivery channels. Service excellence and customer value are how Equitable differentiates itself in the market.

⁽¹⁾ See Non-Generally Accepted Accounting Principles Financial Measures section of this MD&A.

We are excited about our future. As one of the few medium-size banks in Canada with enough scale to make meaningful strategic investments, we are positioned to innovate and deliver a better banking experience to our customers. Our leading-edge technology platform positions us for success in a rapidly changing competitive, consumer, and regulatory landscape. We built our *EQ Bank* platform on Temenos' core banking system and a highly flexible middle tier on which we have layered award-winning interfaces that are available to our customers as an app on their mobile devices. In mid-October 2019, we successfully completed the migration of this technology to Microsoft Azure. We are now the first bank in Canada to host our core banking system in the cloud, giving us the advantage of scalability, reduced costs in the long-run, enhanced security, and the agility to change our products and services quickly. Our innovative *EQ Bank* platform not only allows us to grow our deposit base, it also expands the possibilities for our business by giving us a channel over which to introduce other new products and services.

We are continuously enhancing our systems to ensure that we can leverage our flexible middle tier to provide and consume secure Application Programming Interfaces ("APIs"). This approach allows us to collaborate with fintechs and other partners to deliver a broader range of services to Canadian consumers. We embraced fintech early and have seen the relationships we have built with market leaders such as TransferWise, Borrowell, Ratehub and others, be a driving force in reaching new customers in our markets.

A differentiating factor in Equitable's business model as compared to many other challenger banks around the world is our ability to deploy the deposits that we gather consistently and profitably. We operate an integrated balance sheet and lend across a growing range of retail and commercial asset categories. Our strategy involves continuing to diversify our assets in order to extend our growth runway and achieve our corporate objectives. Diversification provides the added benefit of reducing the risk profile of our business. As with all of our activities, we will approach any new markets carefully. We will pursue opportunities only if they align with our strategy, fit within our risk appetite, exceed our return thresholds, leverage some of our existing capabilities, and present a manageable level of integration risk.

OPEN BANKING

In January of 2019, the Department of Finance released a consultation paper titled "*A Review into the Merits of Open Banking*". It consulted with stakeholders over the following months and released a follow on report "*Consumer-directed finance: the future of financial services*" in January 2020. We support the Government's interest in bringing Open Banking to Canada, as it will enhance competition in the financial services marketplace, and in turn bring more security, transparency, and choice to Canadian consumers. While its recent report demonstrates a commitment to pursuing Open Banking, we believe that the Government needs to move more quickly and take a greater leadership role in the initiative. As written, the report focuses narrowly on security at the expense of competition and broader consumer issues. It also provides a group of industry stakeholders with too much influence in developing the Open Banking framework. While the Government should listen to our input and carefully consider the divergent views of the various stakeholder groups, it will need to decide on the ultimate framework itself or we may reach an impasse.

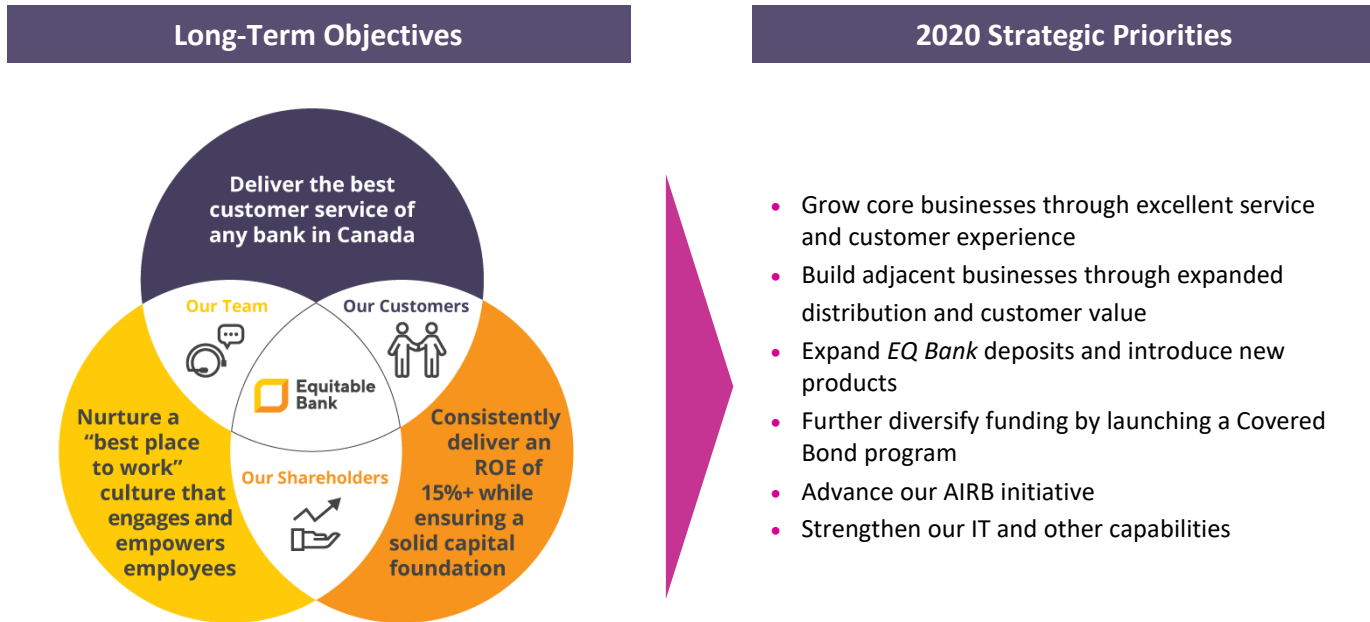
Open Banking is a framework that enables consumers and businesses to easily share access to their financial data with more than one financial institution or fintech, using secure online technology. Currently, each individual financial institution controls access to this information. Open Banking, which has been adopted in other countries already, has the potential to give Canadians greater access to services available in the digital economy that they can use to better and more securely manage their financial affairs.

We believe that a move towards Open Banking will benefit agile and technology-forward banks such as Equitable. Our Bank is laying the groundwork to provide valuable services to our customers that are enabled by the implementation of Open Banking in Canada. We envision a future where *EQ Bank* can serve as a financial hub for our customers by hosting an ecosystem of financial services and leveraging our bank-grade security and stability and in which consumers access our best-in-class products through hubs run by other companies. Our ecosystem will be developed through partnerships with fintechs, brokerages, and other business partners. Given our Challenger Bank culture, our agile and scalable technology infrastructure, and our security posture, *EQ Bank* is in a unique position to innovate and create a better banking experience for Canadians when Open Banking arrives in Canada.

For more information on our views on Opening Banking please refer to our website at <https://www.equitablebank.ca/about-us/open-banking>.

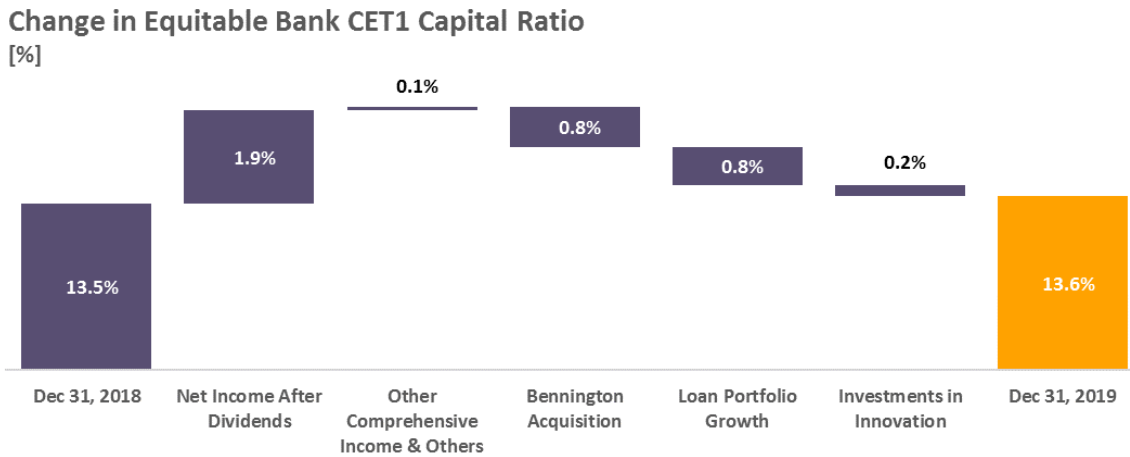
LONG-TERM OBJECTIVES

Our goal is to build a better bank and we have set ambitious long-term objectives for the Company. We believe that our priorities in 2020 will continue us on the path towards achieving those objectives.



CAPITAL DEPLOYMENT

We build capital to fuel our growth primarily by retaining most of our earnings: our retained earnings add approximately 50 basis points to our Common Equity Tier 1⁽¹⁾ (“CET1”) ratio each quarter. After paying a growing dividend, we have been able to profitably deploy this retained capital to achieve double-digit loan growth in our existing businesses. All of our loans must meet well-defined ROE thresholds and contribute to maximizing our overall risk-adjusted returns. A smaller, but still meaningful, amount of equity capital is also allocated to our innovation efforts each year.

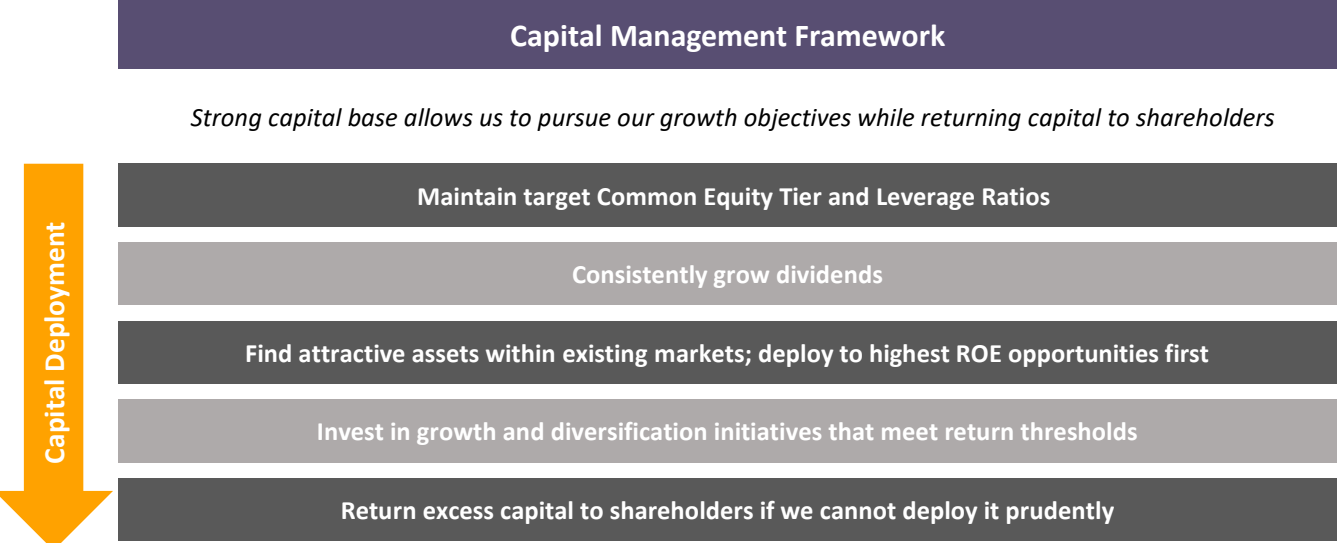


⁽¹⁾ See Non-Generally Accepted Accounting Principles Financial Measures section of this MD&A.

Given the growth and strengthening of Equitable’s business over the past decade, in 2019 management and the Board of Directors considered changes to Equitable's dividend philosophy and evaluated the impact of various approaches to dividend levels on Equitable's stakeholders. The conclusion was that increasing the allocation of capital to dividends was the right decision for the Company. The Board has now committed to growing Equitable's dividend at a rate of between 20% to 25% each year through 2024. Our long-term forecasts indicate that even with this faster pace of dividend growth the Bank will retain sufficient capital to support strong business growth.

If high return growth prospects in any of our existing businesses ever demanded more capital, we would raise additional equity in the markets. Inversely, if we began to generate significant excess capital that we could not deploy prudently in our existing businesses, we would either seek new businesses or return the excess capital to our shareholders. For example, we acquired Bennington in 2019 with our internally generated excess capital. Any capital return activities such as stock buybacks would be executed within defined parameters and with the goal of maximizing long-term shareholder value.

We intend to achieve our growth organically over the medium-term and do not anticipate any significant acquisition activity during that period. At the moment, management believes that focusing on building its current businesses - and executing with excellence - will deliver more shareholder value than pursuing acquisitions. Management still intends to maintain access to the capital markets, so that it has the capacity to finance acquisitions in the future if accretive and sizeable acquisition opportunities present themselves.



OUR CULTURE AND VALUES

Our values define how we conduct ourselves in the market and with each other. Our culture has evolved over time and has helped us foster these common values, guiding the way we think and work, and ultimately paving a better way forward as *Canada’s Challenger Bank™*.

Articulated values are common at many companies, but they are difficult to live by. We work relentlessly to ensure that they are a living embodiment of how we approach each interaction we have with the world around us. To this end, every employee’s performance appraisal includes an assessment of their approach to our values. We believe in empowering our people so that we can increase our agility. Respect and integrity form part of the foundation of our values and service is our keystone. These values are what makes Equitable a satisfying place to work.



CAPABILITIES

We compete successfully with other financial institutions on the basis of our Challenger Bank strategy and our ability to execute well against it. Our execution reflects the breadth and depth of our capabilities and strengthening these capabilities is a strategic priority for us in 2020 and over the long-term.



Our People

Equitable depends on skilled, productive, and engaged employees at all levels to deliver on our strategies and meet our commitment to service excellence. We have a diverse and talented team of almost 900 employees, led by a senior management team that has numerous years of relevant experience.



Strong and Diverse Partnerships

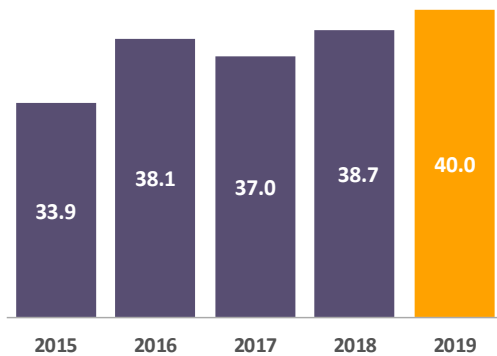
We have built long-term distribution relationships that are mutually beneficial and serve to increase our share of the lending and savings markets. These deep partnerships extend across mortgage brokers, leasing brokers, commercial mortgage originators, wealth managers, and fintechs. They allow us to cost-effectively reach a broader range of Canadian retail and commercial customers, and bring new products and services to market more quickly.



Leading Technology Platform

Enabled by a state-of-the-art global banking platform, we have created a digital nervous system that positions us to offer Canadians a better banking experience. Our core systems are scalable and flexible; and in 2019 they have become even more so, when we became the first Canadian bank to migrate our core banking system to the cloud. We have also organized our data in a single data warehouse so that key information is accessible and useful to both our customers and Equitable. Finally, our customer facing interfaces are designed to be user-centric and intuitive.

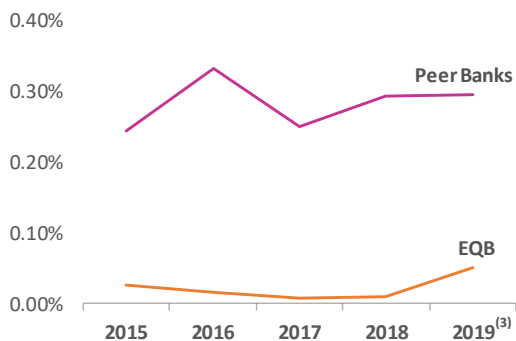
Adjusted Efficiency Ratio⁽²⁾ [%]



Efficient Operations

Equitable is the most efficient⁽¹⁾ Schedule I Bank of the nine Schedule I banks in Canada included in the TSX Composite Index, and one of the very few that operates entirely without a physical retail presence. Due to our branchless operating model, we have a low level of fixed expenses and a highly flexible cost structure. Despite investments in strategic initiatives over the past five years, we have managed to sustain an industry leading Efficiency Ratio. Our low costs allow us to offer more value to our customers including paying higher interest rates to our depositors.

Normalized PCL – rate⁽²⁾



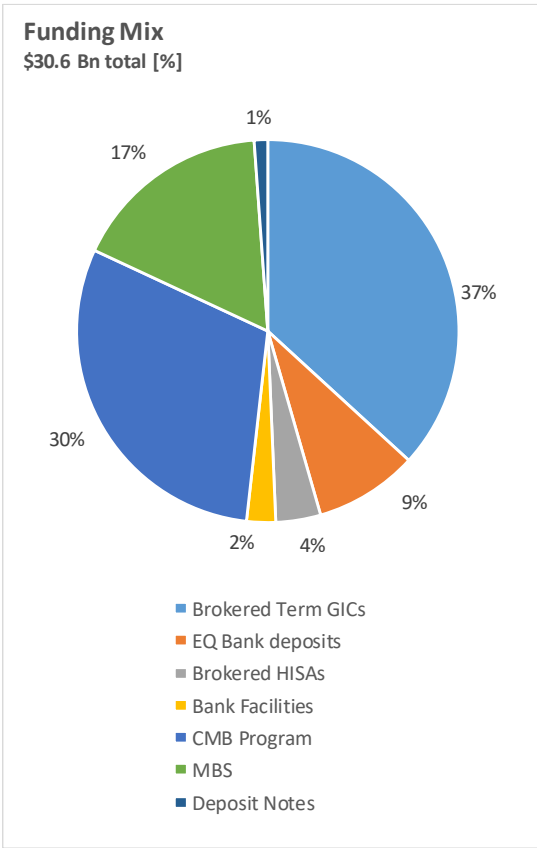
Rigorous Risk Management Standards

We have a mature risk management framework that guides all of our activities. The philosophy that underpins our approach is that we operate within a strict risk appetite and we will not stretch that appetite in order to achieve our growth objectives. We regularly analyze our performance across various key risk indicators and take action quickly if results begin to move outside of our tolerance levels. Our rigorous framework, along with broadly positive Canadian economic conditions, has resulted in an average provision for credit losses (“PCL”) – rate⁽²⁾ of just 0.03% over the past five years. Our loss rates increased in 2019 as expected after we acquired the Bennington equipment leasing business. The leasing business has higher expected losses than our mortgage portfolio, but its higher margins offset those costs.

⁽¹⁾ As measured by the Efficiency Ratio and for the fiscal year 2019.

⁽²⁾ See Non-Generally Accepted Accounting Principles Financial Measures section of this MD&A.

⁽³⁾ The PCL rate for 2019 excludes the one-time \$5.7 million IFRS 9 provision recorded on the acquisition of Bennington and is skewed as a result of consolidating Bennington’s results. Excluding Bennington’s impact, the PCL rate on our mortgage portfolio is 0.02%, which remains consistent with historical levels.



Diversified and Cost-Effective Funding

As a federally regulated deposit-taking institution, and member of the Canada Deposit Insurance Corporation (“CDIC”), we offer secure deposit products to savers in all Canadian jurisdictions. These deposits fund our unsecuritized assets and over the long term have served as a reliable source of funding and asset-liability matching. We also participate in Canada Mortgage and Housing Corporation (“CMHC”) programs that allow us to securitize insured mortgages cost-effectively. These and other diversified funding sources, coupled with our low cost operations, enable Equitable Bank to grow and to be price competitive in our chosen lending markets. Although our current sources of funding are sufficient to meet our needs, we intend to further diversify them to reduce our risk profile and fuel our long-term growth. We expect *EQ Bank* and covered bonds to be the most significant sources of funding growth for Equitable over the medium-term.

OUR BUSINESS LINES

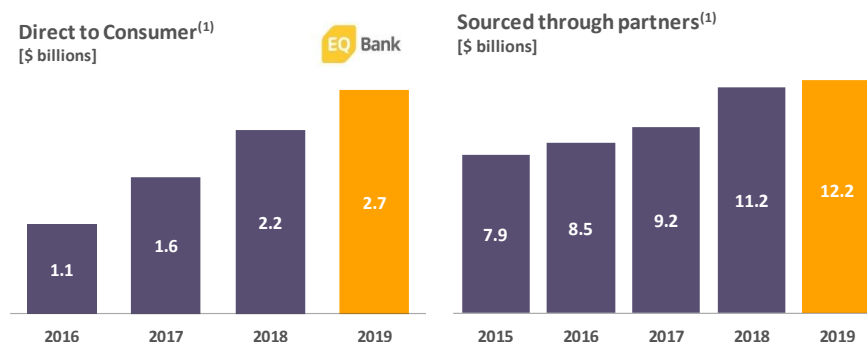
We organize our operations according to products and target customers:

Deposit Taking:

Our Deposit Taking business sources funds directly from consumers and through partners.

We launched *EQ Bank* in 2016 as a means of directly reaching Canadian savers who are looking for an alternative to Canada’s big banks. *EQ Bank* products offer an everyday high interest rate, convenient features, and a seamless digital experience. Our flexible technology platform, based in the cloud, enables us to easily connect to other business partners such as fintechs, and provides us with the agility to bring new products and services to market quickly. For example, in 2019, we partnered with TransferWise to offer Canadians a cost effective and user-friendly international money transfer service. We have an extensive roadmap for the *EQ Bank* platform and intend to bring a range of new products and services to Canadian consumers in the coming years.

For almost 50 years, we have offered a suite of safe and secure deposit products through third party agents, investment dealers, and financial planners across the country. Our products include Guaranteed Investment Certificates (“GICs”) and High Interest Savings Accounts (“HISA”s) designed for Canadian savers looking to build their savings or who have short to medium-term liquidity needs. Responsive service, high rates, and a competitive product offering have been the key factors in our success.

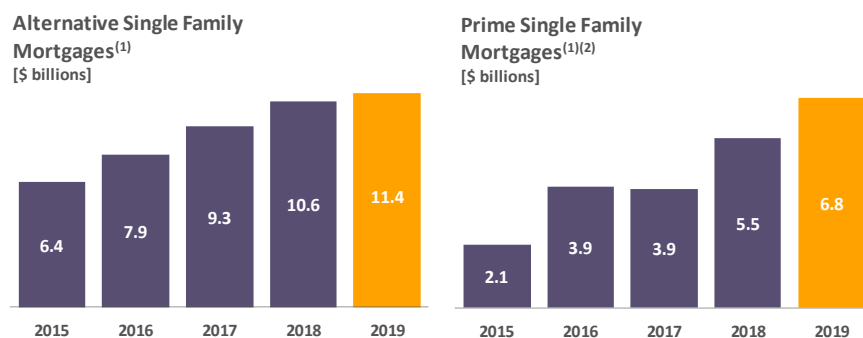


Retail Lending:

Our Retail Lending business consists of Alternative Single Family Lending, Prime Single Family Residential, and our decumulation businesses. Our success in Retail Lending results from our superior level of service, disciplined approach to credit, and favourable market dynamics. We offer first and insured mortgages and Home Equity Lines of Credit (“HELOCs”) on residential properties across Canada, distributed through a network of independent mortgage brokers. Our clients include prime, business-for-self, new to Canada, and credit challenged borrowers. Our deep relationships with mortgage brokers have allowed us to build our retail portfolio consistently. We supplement our internal originations when market opportunities present themselves through acquisitions from third party distribution partners.

We have begun to build a decumulation business by expanding our retail product offerings to include reverse mortgages and CSV Lines of Credit. This business aims to serve Canadians in the decumulation phase of their lives who want to unlock their home equity or the cash surrender value of their whole life insurance policies in a tax efficient manner. It gives a growing Canadian demographic financial flexibility to retire comfortably and pursue their retirement dreams. Equitable distributes reverse mortgages through Canadian mortgage brokers and financial planners, and the CSV product through financial planners. CSV loans are currently available against policies from six major Canadian insurers.

⁽¹⁾ Represents total principal outstanding.



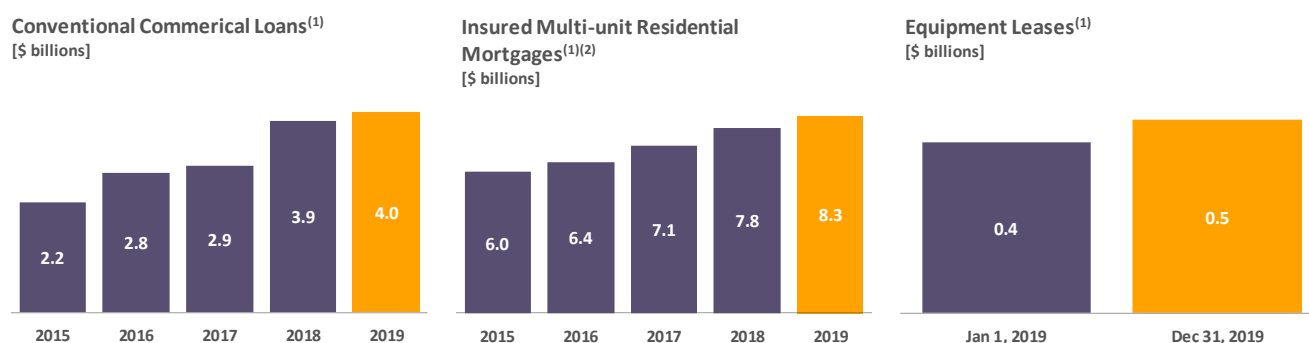
Commercial Lending:

Our Commercial Lending business consists of Conventional Commercial, Insured Multi-unit Residential, Specialized Financing and Equipment Leasing assets. Commercial Lending competes based on service excellence, the breadth and strength of our partnerships, and our in-depth knowledge of our markets. Our distribution is through mortgage and leasing brokers, mortgage banks, and other financial institutions, as well as directly to borrowers.

In Conventional Commercial, we work with our clients, both big and small, to find mortgage solutions for a variety of commercial property types including construction, mixed use, conventional and insured multi-unit residential, shopping plazas, professional offices, and industrial.

Commercial Lending includes a \$239 million Specialized Financing business. Our specialized financing team offers structured financing solutions, tailored to help other specialty lenders finance their growth. The solutions are structured in a manner that mitigates the risk for Equitable and optimizes the capital treatment. We are encouraged by the business and its potential.

On January 1, 2019, we acquired Bennington, a leasing company that finances a wide range of assets with a focus on transportation, construction, and food service equipment. Bennington has long-tenured relationships with professional leasing brokers across Canada and employs a proven approach to adjudication with emphasis on lease structure, security, and re-marketability, which is aligned well to Equitable's proven approach in its real estate lending businesses.



⁽¹⁾ Represents total principal outstanding.

⁽²⁾ Includes the principal of Derecognized Mortgages.

MEDIUM-TERM OBJECTIVES AND KEY PERFORMANCE INDICATORS

Equitable has established medium-term financial targets that allow management, the Board, and our shareholders to assess the success of our strategy over time. These targets are a new approach for us in 2020. We adopted them in response to investor feedback, to align with broader market practices, and to provide a longer-term view that supplements the annual outlook in our MD&A.

Equitable has set four medium-term performance objectives:

| Performance Objectives | What it Represents and Why It Matters | 3-year Objective |
|--|---|------------------|
| Adjusted ROE⁽¹⁾ | <ul style="list-style-type: none"> The earnings generated for our common shareholders, relative to the book value of our equity Reflects our ability to allocate and deploy capital in a disciplined manner and operate an efficient business | 15% – 17% |
| Adjusted Earnings per Share (“EPS”)⁽¹⁾⁽²⁾ Growth | <ul style="list-style-type: none"> The earnings generated after paying preferred share dividends divided by average common shares outstanding relative to prior periods Measures our ability to grow earnings and sustain high returns for our shareholders | 12% – 15% |
| Dividend Growth | <ul style="list-style-type: none"> The annualized growth rate of dividends paid per common share Reflects our commitment to growing our payout ratio but at the same time retaining the majority of our earnings to fuel our growth | 20% – 25% |
| CET1 Ratio | <ul style="list-style-type: none"> The amount of loss-absorbing capital invested in our business, relative to the size of our risk-adjusted asset base Signifies our ability to protect our depositors and the Bank in the event of financial stress | 13% – 14% |

⁽¹⁾ Adjusted results exclude non-recurring or unusual items that have significant impact on the user’s assessment of business performance.

⁽²⁾ See Non-Generally Accepted Accounting Principles Financial Measures section of this MD&A.

In addition to the metrics above, we believe a number of other metrics are important in assessing the performance of the business and effectiveness of our strategy. The additional key performance metrics that we monitor and consider important for investors are:

| Other Key Metric | What it Represents and Why It Matters |
|---|---|
| Net Interest Margin (“NIM”)⁽¹⁾ | <ul style="list-style-type: none"> • The excess of our interest revenues over our funding costs, as a percentage of our average interest earning assets • Represents the profitability of our loan book and is one of the key performance indicators for each business segment • NIM, measured at the consolidated level, may vary from period to period as a result of changes in asset mix |
| PCL – rate | <ul style="list-style-type: none"> • The PCL of both principal and interest recorded during the year, as a percentage of average loan principal • Reflects the credit quality of our loan book and our ability to mitigate potential losses thereon • May be influenced by our asset mix (for example, it increased in 2019 due to the acquisition of a leasing business) |
| Loans under Management (“LUM”)⁽¹⁾ | <ul style="list-style-type: none"> • The sum of loan principal recognized on the consolidated balance sheet and loan principal derecognized but still managed by the Company • Measures the size and growth of our lending business |
| Efficiency Ratio | <ul style="list-style-type: none"> • Non-interest expenses as a percentage of our net revenue⁽¹⁾ • Gauges how much it costs us to generate each dollar of net revenue and indicates how efficiently we operate |
| Employee Engagement | <ul style="list-style-type: none"> • Measured based on an annual third-party survey of our employee base that benchmarks us against other employers • Signifies the commitment and satisfaction of our employees, a key driver of our success. High engagement correlates with reduced turnover and higher productivity, and it is often considered a forward-looking indicator of performance. |

⁽¹⁾ See Non-Generally Accepted Accounting Principles Financial Measures section of this MD&A.

FINANCIAL OVERVIEW

Table 1: Selected Financial Information

| (\$ THOUSANDS, EXCEPT SHARE, PER SHARE AMOUNTS AND PERCENTAGES) | As at or for the years ended | | | | |
|---|------------------------------|-----------------------------|--------------|------------------|--------|
| | Dec 31, 2019 ⁽¹⁾ | Dec 31, 2018 ⁽¹⁾ | Dec 31, 2017 | Change from 2018 | |
| RESULTS OF OPERATIONS | | | | | |
| Net income | \$ 206,479 | \$ 165,626 | \$ 160,617 | \$ 40,853 | 25% |
| Adjusted net income ⁽²⁾ | 211,890 | 172,778 | 160,400 | 39,112 | 23% |
| Net income available to common shareholders | 201,788 | 160,863 | 155,854 | 40,925 | 25% |
| NII | 462,648 | 348,381 | 308,362 | 114,267 | 33% |
| Total revenue | 1,151,226 | 887,722 | 751,488 | 263,504 | 30% |
| EPS – basic | 12.10 | 9.73 | 9.46 | 2.37 | 24% |
| EPS – diluted | 11.97 | 9.67 | 9.39 | 2.30 | 24% |
| Adjusted EPS – diluted | 12.29 | 10.10 | 9.38 | 2.19 | 22% |
| ROE | 15.5% | 14.1% | 15.8% | N/A | 1.4% |
| Adjusted ROE | 15.9% | 14.7% | 15.8% | N/A | 1.2% |
| Return on average assets ⁽²⁾ | 0.8% | 0.7% | 0.8% | N/A | 0.1% |
| NIM | 1.74% | 1.59% | 1.58% | N/A | 0.15% |
| Efficiency Ratio ⁽³⁾ | 40.2% | 39.7% | 36.9% | N/A | 0.5% |
| BALANCE SHEET | | | | | |
| Total assets | 28,392,452 | 25,037,145 | 20,634,250 | 3,355,307 | 13% |
| AUM | 33,005,353 | 29,410,999 | 24,652,969 | 3,594,354 | 12% |
| Loans receivable | 26,607,830 | 23,526,404 | 19,298,548 | 3,081,426 | 13% |
| LUM | 31,123,254 | 27,800,546 | 23,233,420 | 3,322,708 | 12% |
| Preferred shares | 72,557 | 72,557 | 72,557 | - | -% |
| Common shareholders' equity | 1,395,157 | 1,207,470 | 1,065,560 | 187,687 | 16% |
| CREDIT QUALITY | | | | | |
| PCL ⁽⁴⁾ | 18,394 | 2,083 | 1,543 | 16,311 | 783% |
| PCL – rate | 0.07% | 0.01% | 0.01% | N/A | 0.06% |
| Net impaired loans as a % of total loan assets ⁽⁵⁾ | 0.44% | 0.16% | 0.12% | N/A | 0.28% |
| Allowance for credit losses as a % of total loan assets | 0.14% | 0.11% | 0.17% | N/A | 0.03% |
| SHARE CAPITAL | | | | | |
| Common shares outstanding | 16,797,593 | 16,554,018 | 16,503,437 | 243,575 | 1% |
| Book value per common share ⁽⁶⁾ | 83.06 | 72.94 | 64.57 | 10.12 | 14% |
| Common share price – close | 109.35 | 59.12 | 71.50 | 50.23 | 85% |
| Common share market capitalization | 1,836,817 | 978,674 | 1,179,996 | 858,143 | 88% |
| Dividends declared per: | | | | | |
| Common share | 1.29 | 1.08 | 0.95 | 0.21 | 19% |
| Preferred share – Series 3 | 1.56 | 1.59 | 1.59 | (0.03) | (2%) |
| EQUITABLE BANK CAPITAL RATIOS⁽²⁾ | | | | | |
| CET1 Ratio | 13.6% | 13.5% | 14.8% | N/A | 0.1% |
| Tier 1 Capital Ratio | 14.4% | 14.3% | 15.9% | N/A | 0.1% |
| Total Capital Ratio | 14.7% | 14.5% | 16.3% | N/A | 0.2% |
| Leverage Ratio | 4.9% | 5.0% | 5.4% | N/A | (0.1%) |

⁽¹⁾ Effective January 1, 2018, the amounts and ratios have been prepared in accordance with IFRS 9. Prior year comparatives were prepared in accordance with IAS 39 and have not been restated. As a result, 2019 and 2018 disclosures are not directly comparable to prior years.

⁽²⁾ See Non-Generally Accepted Accounting Principles Financial Measures section of this MD&A.

⁽³⁾ Increases in this ratio reflect reduced efficiencies, whereas decreases reflect improved efficiencies.

⁽⁴⁾ 2019 provision for credit losses includes \$14.5 million of provisions for equipment leases acquired through the Bennington acquisition.

⁽⁵⁾ Effective January 1, 2018, as a result of adoption of IFRS 9, net impaired mortgages have been revised to include all mortgages that are in arrears 90 days or more and reflect gross impaired mortgage assets less stage 3 allowances. Prior year net impaired mortgages are presented under IAS 39 and do not include insured mortgages that are less than 365 days in arrears. Prior year net impaired mortgages equals gross impaired mortgage assets less individual allowances.

⁽⁶⁾ The adoption of IFRS 9 resulted in a \$0.42 increase in our book value per common share as at January 1, 2018. The adoption of IFRS 16 resulted in a \$0.05 decrease in our book value per common share as at January 1, 2019.

2019 HIGHLIGHTS

PERFORMANCE AGAINST 2019 STRATEGIC PRIORITIES

Equitable generated all-time record earnings in 2019 as we continued to demonstrate our franchise value and deliver on our strategic priorities. This performance was mainly attributable to our success in growing mortgage assets, reduced backstop funding facility costs, low losses, and the acquisition of Bennington at the beginning of the year. Adjusted EPS and ROE were \$12.29 and 15.9%, respectively, compared to \$10.10 and 14.7% in 2018.

Adjusted 2019 results exclude the negative impact of a \$5.7 million IFRS 9 related provision for credit losses on performing equipment leases recorded immediately after the acquisition of Bennington and \$1.6 million of net mark-to-market losses of on certain security investments and derivative financial instruments. Including these items, reported EPS and ROE were \$11.97 and 15.5%, respectively.

Our accomplishments in 2019, coupled with ongoing strategic investments, lay the foundation for more success in future years.

| Strategic Objectives for 2019 | Accomplishments |
|--|---|
| <p>Grow our existing businesses with better service and innovation</p> | <ul style="list-style-type: none"> • Grew both of our Retail and Commercial loan portfolio by 13% • Introduced Equitable Trust term deposits to the broker channel • Achieved an almost three-fold increase in deposits from strategic partnerships • Successfully raised \$350 million through two deposit note issuances with high investor demand and on average 16 bp tightened spreads • Developed a USD HISA product for the broker market and subsequently launched it in January 2020 |
| <p>Further diversify through our leasing, reverse mortgage, and CSV loan businesses</p> | <ul style="list-style-type: none"> • Grew our equipment lease portfolio by \$58 million since acquiring Bennington and have seen demand build for its higher quality lease offerings • Launched the <i>Equitable Bank Reverse Mortgage</i> product in Québec in May, which is part of our broader strategy to build a competitive decumulation business • Continued to improve reverse mortgage and CSV line of credit product awareness while refining our offerings in response to market feedback • Doubled the number of distribution partners for our CSV products as we launched partnerships with BMO Insurance, Empire Life, and iA Financial Group • Launched CSV MAX line of credit that offers age-of-majority Canadians a higher loan-to-value solution as long as they can service the monthly interest payment |
| <p>Expand and enhance EQ Bank</p> | <ul style="list-style-type: none"> • Expanded our customer base by 24,500 or 35% to over 95,000 • Grew <i>EQ Bank</i> deposit balances to \$2.7 billion, an increase of 22% • Launched an international money transfer service that is up to 8 times cheaper, and is faster and more convenient than those offered by our peer banks • Enhanced customer experience through website modernization and an upgrade of onboarding, mobile, and web functionality • Launched a TV and digital marketing campaign that increased our brand awareness and demonstrated the clear value we bring to Canadians |

| Strategic Objectives for 2019 | Accomplishments |
|--|---|
| <p>Pursue AIRB and improve the sophistication of our capital management</p> | <ul style="list-style-type: none"> • Committed to increasing our dividend by 20% to 25% per year through 2024 • Submitted our AIRB implementation plan to OSFI and continued to progress the overall initiative • Reported a CET1 Ratio of 13.6%, which remained ahead of most competitive benchmarks and above the middle of our target range • Reduced the size of our secured backstop funding facility to \$400 million and renewed it for a 2-year period at reduced costs |
| <p>Enhance our capabilities through technology and people</p> | <ul style="list-style-type: none"> • Successfully completed the migration of our <i>EQ Bank</i> platform and other applications to the cloud in Q4 2019 • Sustained an industry leading Efficiency Ratio⁽¹⁾ of 40.2% while still investing in strategic initiatives • Joined the S&P/TSX Composite Index on September 23, 2019 • Began to develop our Covered Bond Program with a goal of a mid-2020 launch • Received DBRS' annual rating confirmation, which was held at 'BBB' but with the trend improving to Positive from Stable |

⁽¹⁾ As measured by the Efficiency Ratio for 2019

ITEMS OF NOTE

Our 2019 financial results were impacted by the following items, on a pre-tax basis:

- \$5.7 million one-time IFRS 9 related provision for credit losses for Bennington's equipment lease portfolio that was recorded at the time of acquisition; and
- \$1.6 million of net mark-to-market losses on certain security investments and derivative financial instruments related to securitization activities.

Our 2018 financial results were impacted by the following items, on a pre-tax basis:

- \$5.9 million write-down of unamortized up-front costs associated with a reduction in the size of the Bank's secured backstop funding facility; and
- \$3.9 million of net mark-to-market losses on certain preferred share investments.

DIVIDENDS

Common share dividends

On February 24, 2020, the Company's Board declared a quarterly dividend of \$0.37 per common share, payable on March 27, 2020, to common shareholders of record at the close of business on March 13, 2020. This dividend represents a 23% increase over dividends declared in February 2019 in line with the Board's plan to increase the dividend at an annual rate of 20% to 25% over the next five years.

On February 28, 2019, the Board reinstated Equitable's common share Dividend Reinvestment Plan ("DRIP").

On February 24, 2020, the Company's Board suspended Equitable's common share DRIP due to the strength of our capital position and confidence in our ability to generate sufficient capital over the medium to long-term to support the growth of the Bank.

Preferred share dividends

On August 22, 2019, Equitable announced that it did not intend to exercise its right to redeem all or any part of its outstanding non-cumulative redeemable 5-year rate reset Preferred Shares, Series 3 (the “Series 3 Preferred Shares”) on September 30, 2019. As a result, holders of Series 3 Preferred Shares had the right, at their option, to convert all or part of their Series 3 Preferred Shares, on a one-for-one basis, into non-cumulative floating rate Preferred Shares, Series 4 (“Series 4 Preferred Shares”). On September 16, 2019, the Company announced that after taking into account all election notices received, less than the minimum 800,000 shares required to give effect to the conversion were tendered. As a result, no Series 4 Preferred Shares were issued and holders of Series 3 Preferred Shares retained their shares.

On September 3, 2019, the Company announced the dividend rate applicable on Series 3 Preferred Shares on September 30, 2019 for the five-year period from, and including, September 30, 2019 to, but excluding, September 30, 2024 would be 5.969% per annum, or \$0.373063 per preferred share per quarter, compared to the previous payout of 6.35% or \$0.396875 per preferred share per quarter.

On February 24, 2020, the Board declared a quarterly dividend of \$0.373063 per preferred share, payable on March 27, 2020, to preferred shareholders of record at the close of business on March 13, 2020.

BUSINESS OUTLOOK

Equitable believes that our strategy, including our disciplined approach to capital allocation, will continue to deliver value to shareholders and protect the money that depositors have trusted to the Bank. Our asset quality remains high and our diversified business model presents profitable growth opportunities.

We anticipate our earnings growth will outpace that of the broader Canadian banking industry in 2020, based on consensus forecasts for other banks. Management expects earnings to increase at a rate in the range of 4% to 8% in 2020 as a result of loan growth, stable margins, and low provisions for credit losses. Our earnings growth rate will be below our longer-term average and medium-term targets due to significant investments that we intend to make in growing our digital platform, building our emerging lending businesses, and strengthening our IT capabilities. Adjusted ROE should be between 14% and 16%, down slightly from 2019 due to both higher levels of capital (in 2019 we were below target levels) and lower earnings growth.

Asset Growth

The Bank operates secured lending businesses that span a diversified spectrum of asset types. Our diversification initiatives are critical to enabling our long-term growth objectives. They also reduce our risk profile and increase the depth of our relationships with our customers and distribution partners, creating more value for our shareholders over the long-term.

As a result of our continued emphasis on service quality and our business diversification initiatives, we expect that loans will grow at a rate between 8% and 12% in 2020. We describe our growth expectations for individual loan categories in detail below.

Summary of Expectations for Asset Growth for 2020

| Portfolio | Expectations ⁽¹⁾ | Rationale and Assumptions |
|--|---|---|
| Retail | | |
| Alternative Single Family | Assets grow at a rate between 5% and 9% | <ul style="list-style-type: none"> Employment will be stable and overall economic growth will be low but positive Housing market activity and prices will increase across our key markets (at rates in the mid-single digits) Originations will be up from 2019 as a result of growth in the Alternative market segment and gains in market share Attrition rates will be consistent with the latter half of 2019 |
| Prime Single Family | Assets grow at a rate between 20% and 25% | <ul style="list-style-type: none"> The economy and housing market perform as indicated above Our internally originated prime business will continue to broaden its broker relationships and gain market share as it did in 2019 We will source up to \$1 billion from third parties over the year, and \$350 million in Q1 alone |
| Commercial | | |
| Conventional Commercial | Assets grow at a rate between 8% and 12% | <ul style="list-style-type: none"> The market continues to present quality origination opportunities, particularly in the Multi space, and competition does not intensify We are able to expand our Specialized Financing business through new partnerships and asset classes Originations are consistent with the levels achieved in 2019 while attrition rates are slightly higher |
| CMHC Insured Multi-Unit Residential ("Multi") | Balance sheet assets decrease up to 4% | <ul style="list-style-type: none"> We will use our fixed rate CMB capacity (approximately \$350 million to \$400 million per quarter) for Multi renewals and originations We will derecognize in the range of \$150 million to \$200 million of securitized Multis each quarter |
| Equipment Leasing | Assets grow at a rate between 15% and 20% | <ul style="list-style-type: none"> The overall economy and the leasing market will grow modestly Originations will increase as we continue to deliver high quality service to brokers and build out our product offering |

⁽¹⁾ All growth rates listed in this table are with reference to the prior year unless noted otherwise.

The Bank may not realize the expected asset growth rates indicated in the table above if business or competitive conditions, funding availability, the regulatory environment, the housing market, or general economic conditions change, or if any of the other assumptions outlined in the table do not materialize in the amount or within the timeframes specified.

Revenue

Management believes that NII will increase at a year-over-year rate between 7% and 11% in 2020. A high level of loan growth will be the primary contributor to the increase.

NIM should be in the range of 1.65% to 1.75% for the full year 2020, down slightly from 2019 partly because high growth of our narrow Prime Single Family assets will cause a mix shift in the portfolio. Margins within each of our businesses should be consistent with 2019 levels. Quarterly NIM may fluctuate and differ from our expectations due to prepayment income volatility and other factors such as seasonal variations in our liquidity holdings.

Non-Interest Expenses

We intend to invest significantly in strategic initiatives during 2020. These investments will contribute to higher than normal growth in our non-interest expenses while much of the related revenue may not materialize for several years. As a result, these initiatives will compress our earnings until they achieve a reasonable scale. On a net present value basis, we expect all of the investments to be profitable over a five to ten year horizon. For example, if we invest in marketing now to grow our *EQ Bank* customer base, each new account will provide lifetime value that is at least five times the acquisition cost – though the acquisition cost will have a negative impact on our Net Income in the current period while the value will be realized over time. These initiatives will also create strategic value for the company and lead to higher long-term shareholder value.

Management expects that total non-interest expenses will increase by \$30 million to \$35 million (15% to 18%) from 2019, as a result of strategic investments and the continued growth of our business. Between \$5 and \$7 million of the expected expense growth relates to strategic initiatives that include, among other things:

- Significantly increasing our *EQ Bank* marketing spend to increase the rate of new customer acquisition;
- Launching a Covered Bonds Program;
- Developing service improvement strategies in our retail lending businesses;
- Building out our attractive international money transfer service;
- Launching registered accounts on the *EQ Bank* platform;
- Introducing joint accounts to *EQ Bank*; and
- Developing and securing distribution for brokered US currency and long-term GICs.

The actual expenses could vary from the expectations above depending on the timing and nature of the expenditures. For example, more or less expenditures may be eligible for capitalization than we are assuming in our current forecast.

Even with these investments, the Bank will continue to operate efficiently on both an absolute and relative basis compared to most other financial institutions due to our branchless business model. We expect that our Efficiency Ratio will be between 40% and 42% in 2020, and likely at the high end of that range. This Efficiency Ratio is higher than our historical average due to the effect of strategic investments and the addition of Bennington.

Capital

Our capital ratios were at target levels at the end of 2019, after they declined earlier in the year due to the strategic acquisition of Bennington. We expect them to stay in our target range through 2020, and most importantly, our CET1 ratio should remain at approximately 13.5%. At current levels, our capital ratios are above regulatory standards and the levels of the other eight Schedule I banks in Canada included in the TSX Composite Index.

We continue to advance our AIRB initiative with the objective of operationalizing our risk rating and capital calculations, as well as filing our pre-application package with OSFI, by the end of 2020. Our objective is to transition to AIRB by the end of 2022. We note that setting objectives for obtaining regulatory approval to operate on an AIRB basis may include assumptions outside of the Bank's full control, and that unforeseen delays may occur. The benefits of AIRB include improving the sophistication of our risk management, allocating appropriate levels of capital to our risks, and introducing capital methodologies that allows us to compete more effectively across a broader range of assets. Our ongoing analysis also continues to confirm that AIRB has the potential to have a meaningful impact on our total risk-weighted assets and related potential economic benefit to the Bank.

Dividends

Our franchise has grown and strengthened materially over the past decade. We have entered new business lines, firmly established our position as *Canada's Challenger Bank™*, maintained a strong capital position and generated high ROEs. Given this improved position, in July 2019 the Board announced an intention to grow our dividend at a rate between 20% and 25% for each of the next five years. Even with a faster pace of dividend growth, we expect to maintain a strong capital position and to retain sufficient capital to support our growth objectives.

Funding

We believe that our current sources of funding – most notably brokered term and *EQ Bank* deposits – will be adequate to support our asset growth. Our deposit balances have grown by 13% over the past 12 months and we believe this trend will continue, even with what we expect to be a continued high level of competition in the deposit market. Similarly, our access to CMHC sponsored securitization programs will provide more than enough capacity to fund our insured Prime Single Family and Multi growth.

Nonetheless, management will continue to diversify the Bank's funding profile for risk management and long-term growth purposes. As in recent years, we will invest in growing *EQ Bank* customer accounts and balances, with the objective of having that platform provide one-third of our non-securitization funding by the end of 2024. We are also optimistic about the potential for covered bonds to become a meaningful source of funding for the Bank that will likely be lower cost than deposits. We are currently developing our program and hope to issue our first bonds in Q3 2020.

Credit Quality

Management consistently manages credit risk through the application of prudent lending practices. This approach applies across all of our lending businesses, including leasing. Equitable's arrears rates and provisions for credit losses were low again in 2019, though the Bennington acquisition caused an increase relative to Equitable's historical levels.

We anticipate that the longer-term annualized loss rate on the Bennington equipment leasing portfolio will be in the range of 1.5% to 2.0%, a level of loss that is within our risk appetite. The equipment leasing business has higher expected losses than does our mortgage business, but we earn higher yields to compensate for this cost. Bennington's impaired loan balances should grow over time in-line with the overall lease portfolio.

Recent economic data supports our view that risk in the Canadian residential real estate market has moderated over the past two years. Employment rates remain high and the housing markets in most major urban centres are now demonstrating balanced supply and demand dynamics. With that backdrop, we expect credit loss provisions in our mortgage book to be low in 2020, assuming that Canadian economic conditions stay within the range of broad market expectations. Mortgage arrears rates in our Single Family book should also remain low and consistent with 2019 levels.

Nonetheless, we believe that risks still exist and we are actively monitoring mortgage market activity. Our prudent risk appetite and approach to lending should allow us to effectively manage through any negative changes in market conditions. For example, the low LTV ratios on our uninsured mortgages are designed to protect the Bank in the event of a softening real estate market and escalating borrower defaults caused by higher levels of unemployment. The weighted average LTV ratio of 65% on our uninsured residential mortgage portfolio at the end of Q4 offers us protection against a scenario combining higher defaults and a significant decrease in house prices.

Similarly, our Commercial Lending portfolio continues to perform well. Arrears rates have been unusually high since Q1 due to one large loan in Vancouver but we expect them to decrease from that level after the loan is resolved, likely in mid-2020. We do not expect to record any losses on that loan.

The purpose of this outlook is to give the reader an indication of factors that may affect Equitable's performance in the near term. Readers should be aware that information contained in this section may not be appropriate for any other purpose. See "Cautionary Note Regarding Forward-Looking Statements" on page 1 of this MD&A.

FINANCIAL REVIEW – EARNINGS

Table 2: Income statement highlights

| (\$ THOUSANDS, EXCEPT PER SHARE AMOUNTS) | 2019 | 2018 | Change | |
|--|------------|------------|-----------|------|
| Net income | \$ 206,479 | \$ 165,626 | \$ 40,853 | 25% |
| Adjusted net income | 211,890 | 172,778 | 39,112 | 23% |
| EPS – diluted | 11.97 | 9.67 | 2.30 | 24% |
| Adjusted EPS – diluted | 12.29 | 10.10 | 2.19 | 22% |
| Net interest income | 462,648 | 348,381 | 114,267 | 33% |
| Provision for credit losses | 18,394 | 2,083 | 16,311 | 783% |
| Non-interest expenses | 199,573 | 149,363 | 50,210 | 34% |

NET INTEREST INCOME

NII is the main driver of profitability for the Company. Table 3 details the Company's NII by product and portfolio.

Table 3: Net interest income

| (\$ THOUSANDS, EXCEPT PERCENTAGES) | 2019 | | | 2018 | | |
|--|-------------------|------------------|-----------------------------|-------------------|-----------------|-----------------------------|
| | Average Balance | Revenue/Expense | Average rate ⁽¹⁾ | Average Balance | Revenue/Expense | Average rate ⁽¹⁾ |
| <i>Revenues derived from:</i> | | | | | | |
| Cash and equivalents | \$ 1,435,296 | \$ 28,881 | 2.01% | \$ 1,134,281 | \$ 18,072 | 1.59% |
| Equity securities ⁽²⁾ | 123,753 | 6,105 | 4.93% | 133,675 | 5,641 | 4.22% |
| Alternative single family mortgages | 11,065,617 | 539,039 | 4.87% | 9,852,921 | 449,030 | 4.56% |
| Prime single family mortgages | 6,065,959 | 146,271 | 2.41% | 4,284,924 | 92,461 | 2.16% |
| Other retail loans | 11,152 | 654 | 5.85% | 1,276 | 95 | 7.42% |
| Total Retail loans | 17,142,728 | 685,964 | 4.00% | 14,139,121 | 541,586 | 3.83% |
| Conventional commercial loans | 3,838,503 | 231,796 | 6.04% | 3,329,119 | 188,193 | 5.65% |
| Equipment leases ⁽³⁾ | 456,910 | 53,095 | 11.62% | N/A | N/A | N/A |
| Insured multi-unit residential mortgages | 3,524,862 | 110,969 | 3.15% | 3,224,180 | 106,571 | 3.31% |
| Total Commercial loans | 7,820,275 | 395,860 | 5.06% | 6,553,299 | 294,764 | 4.50% |
| Average interest earning assets | 26,522,052 | 1,116,810 | 4.21% | 21,960,376 | 860,063 | 3.92% |
| <i>Expenses related to:</i> | | | | | | |
| Deposits | 14,566,963 | 385,197 | 2.64% | 12,334,389 | 290,990 | 2.36% |
| Secured backstop funding facility ⁽⁴⁾ | - | 4,947 | N/A | - | 20,854 | N/A |
| Securitization liabilities | 10,033,573 | 256,364 | 2.56% | 7,842,165 | 191,866 | 2.45% |
| Others | 322,902 | 7,654 | 2.37% | 362,244 | 7,972 | 2.20% |
| Average interest bearing liabilities | 24,923,438 | 654,162 | 2.62% | 20,538,798 | 511,682 | 2.49% |
| Net interest income and margin | \$ 462,648 | 1.74% | | \$ 348,381 | 1.59% | |

⁽¹⁾ Average rates are calculated based on the daily average balances outstanding during the period.

⁽²⁾ Effective January 1, 2019, the revenues from Equity securities are presented excluding a Taxable equivalent basis ("TEB") adjustment. Prior period comparatives have been restated.

⁽³⁾ The revenue derived from and the average rate on Equipment leases represents earnings on the Bennington equipment lease portfolio. Bennington was consolidated as of January 1, 2019.

⁽⁴⁾ Since its establishment in June 2017, there have been no draws on the secured backstop funding facility.

NII was up \$114 million or 33% year-over-year due to growth in average asset balances and a 15 bp increase in total NIM.

Table 4: Factors affecting 2019 v 2018 NIM

| | Impact (in bps) | Drivers of change |
|--------------------------------------|-----------------|---|
| Equipment leases | 11 | • Addition of higher spread equipment leases acquired in Q1 2019 |
| Backstop funding facility fees | 5 | • Fees associated with our downsized and lower rate secured backstop funding facility |
| Backstop funding facility write-down | 3 | • The \$5.9 million write-down of unamortized upfront costs associated with the reduction of our secured backstop funding facility in Q2 2018 |
| Rates/spread ⁽¹⁾ | 4 | • Higher spreads on our Commercial portfolio |
| Business mix | (9) | • Mix shift toward lower spread Prime mortgages, which have experienced higher growth since the latter half of 2018 |
| Other | 1 | |
| Change in Total NIM | 15 | |

⁽¹⁾ The rate effect is calculated after adjusting for the impact of business mix changes.

PROVISION FOR CREDIT LOSSES

Table 5: Provision for credit losses

| (\$ THOUSANDS, EXCEPT PERCENTAGES) | 2019 | | | 2018 | Change | |
|---|-----------|------------|--------------|----------|-----------|-------|
| | Equitable | Bennington | Consolidated | | | |
| Stage 1 and 2 provision | \$ 1,335 | \$ 989 | \$ 2,324 | \$ 215 | \$ 2,109 | 981% |
| Stage 3 provision | 2,578 | 7,743 | 10,321 | 1,868 | 8,453 | 453% |
| PCL – Normalized ⁽¹⁾ | 3,913 | 8,732 | 12,645 | 2,083 | 10,562 | 507% |
| One-time Bennington acquisition related | - | 5,749 | 5,749 | - | 5,749 | N/A |
| PCL – Reported | \$ 3,913 | \$ 14,481 | \$ 18,394 | \$ 2,083 | \$ 16,311 | 783% |
| PCL – Normalized rate | 0.02% | 1.87% | 0.05% | 0.01% | N/A | 0.04% |
| PCL – Reported rate | 0.02% | 3.10% | 0.07% | 0.01% | N/A | 0.06% |

⁽¹⁾ See Non-Generally Accepted Accounting Principles Financial Measures section of this MD&A.

The credit quality of our loan portfolio remained strong in 2019. The \$16.3 million increase in total PCL includes a one-time \$5.7 million IFRS 9 related provision recorded on the acquisition of Bennington. IFRS 9 required us to establish an allowance for credit losses on all performing leases acquired, immediately after the leases came on to our balance sheet. This accounting provision did not change management's view on the quality of the underlying business or the acquired lease portfolio.

Excluding the effect of the one-time provision, our normalized PCL increased by \$10.6 million during the year to \$12.6 million. \$8.7 million or 83% of the increase represents provisions recorded in the year for our lease portfolio. The equipment leasing business has higher expected losses than does our traditional mortgage business but earns a higher margin to compensate for this cost. The PCL on our mortgage portfolio was \$3.9 million, \$1.8 million higher than last year. This increase related mainly to Stage 1 and 2 provisions, which were up as a result of changes in macroeconomic forecasts year-over-year and growth of our Alternative Single Family portfolio. Stage 3 provisions also increased, mainly due to a higher level of defaulted Alternative Single Family loans. Relative to average mortgage principal the PCL was 2 bps, above the 2018 level but still in-line with our historical PCL rates.

The amount of provision may vary from period to period based on impaired loan balances, the credit quality of our unimpaired loans, estimates of the likely credit losses on all loans, and both current and forward-looking economic conditions. The provision does not represent the aggregate amount that we have reserved to absorb losses: the aggregate amount of reserves is represented by the allowance for credit losses on our consolidated balance sheet (see *Credit Quality and Allowance for Credit Losses* discussion below).

OTHER INCOME

Table 6: Other income

| (\$ THOUSANDS) | 2019 | 2018 | Change | |
|---|------------------|------------------|-----------------|------------|
| Fees and other income | | | | |
| Fees and other income | \$ 22,276 | \$ 16,725 | \$ 5,551 | 33% |
| Income from successor issuer activities | 1,579 | 4,504 | (2,925) | (65%) |
| Net loss on investments | (973) | (3,855) | 2,882 | 75% |
| Securitization activities: | | | | |
| Gains on securitization and income from retained interests | 11,703 | 10,279 | 1,424 | 14% |
| Fair value (losses) gains on derivative financial instruments | (169) | 6 | (175) | (2,917%) |
| Total | \$ 34,416 | \$ 27,659 | \$ 6,757 | 24% |

Other income increased compared with 2018, mainly due to:

- Higher Fees and other income, primarily from the equipment leasing portfolio that we acquired in Q1 2019 and overall business growth;
- Lower Net loss on investments, mainly resulting from a decrease in net mark-to-market losses on certain security investments; and
- An increase in Gains on securitization and income from retained interests, due to a higher gain on sale margin and despite lower derecognition volumes;

Offset by:

- Reduced Income from successor issuer activities, representing income earned from certain assets that we previously acquired from Maple Bank and which is expected to be recurring on a diminishing basis through 2020.

NON-INTEREST EXPENSES

Table 7: Non-interest expenses and Efficiency Ratio

| (\$ THOUSANDS, EXCEPT PERCENTAGES AND FTE) | 2019 | 2018 | Change | |
|---|-------------------|-------------------|------------------|------------|
| Compensation and benefits | \$ 101,651 | \$ 77,062 | \$ 24,589 | 32% |
| Technology and system costs | 32,276 | 22,647 | 9,629 | 43% |
| Marketing and corporate expenses | 20,955 | 15,997 | 4,958 | 31% |
| Regulatory, legal and professional fees | 19,518 | 13,949 | 5,569 | 40% |
| Product costs | 16,279 | 13,082 | 3,197 | 24% |
| Premises | 8,894 | 6,626 | 2,268 | 34% |
| Total | \$ 199,573 | \$ 149,363 | \$ 50,210 | 34% |
| Efficiency Ratio ⁽¹⁾ | 40.2% | 39.7% | N/A | 0.5% |
| Full-time employee ("FTE") – period average | 828 | 631 | 197 | 31% |

⁽¹⁾ Effective January 1, 2019, Efficiency Ratio is reported excluding a TEB adjustment. Prior period comparatives have been restated.

We continue to operate efficiently on both an absolute basis and relative to other financial institutions, particularly taking into account the scale of our operations. Overall, non-interest expenses were \$50.2 million or 34% higher than last year. Bennington contributed \$23.3 million of expenses in 2019, \$13.2 million of which related to compensation and benefits (2018 – \$nil).

Excluding Bennington's operating expenses, total non-interest expenses increased \$26.9 million or 18%, mainly because of:

- Higher Compensation and benefits costs, attributable to several factors including a 10% increase in our FTE, annual inflationary adjustments, and year-end performance payouts;

- Growth in Technology and system costs mainly to support, maintain, and enhance of our core banking systems, \$3.0 million of which was a one-time spending incurred in the year for the migration of our *EQ Bank* platform and other systems to the cloud;
- Higher Regulatory, legal, and professional fees, largely due to CDIC premiums on our growing deposits balances;
- An increase in Product costs, mainly pertaining to IT expenses and higher servicing fees arising from business growth;
- Higher Premises expenses, mostly due to an office expansion; and
- An increase in Marketing expenditures related an extensive campaign to promote *EQ Bank* and its products.

INCOME TAXES

Our statutory income tax rate in 2019 decreased by 0.1% to 26.5%. Our effective income tax rate decreased in 2019 to 26.0% from 26.3% a year ago mainly due to a decrease in the tax rate in Alberta, and other adjustments.

FINANCIAL REVIEW – BALANCE SHEET

Table 8: Balance sheet highlights

| (\$ THOUSANDS, EXCEPT PERCENTAGES) | Dec 31, 2019 | Dec 31, 2018 | Change | |
|---|---------------|---------------|--------------|------|
| Total assets | \$ 28,392,452 | \$ 25,037,145 | \$ 3,355,307 | 13% |
| Loan principal – Retail | 18,250,574 | 16,102,163 | 2,148,411 | 13% |
| Loan principal – Commercial | 8,259,779 | 7,324,529 | 935,250 | 13% |
| Deposit principal | 15,231,888 | 13,522,012 | 1,709,876 | 13% |
| Total liquid assets ⁽¹⁾ as a % of total assets | 6.0% | 5.6% | N/A | 0.4% |

⁽¹⁾ See Non-Generally Accepted Accounting Principles Financial Measures section of this MD&A.

Equitable generated strong growth in 2019, with Total assets increasing by \$3.4 billion or 13% from last year. The increase was primarily driven by growth in our Prime and Alternative single family businesses and the addition of Bennington's equipment lease portfolio on January 1, 2019.

TOTAL LOAN PRINCIPAL

Our strategy is to maintain a diverse portfolio of loan assets in order to optimize our ROE and maintain credit risk at an acceptable level. Table 9 presents our loan principal by lending business and Table 10 provides continuity schedules for our on-balance sheet loan assets.

Table 9: Loan principal by lending business

| (\$ THOUSANDS) | Dec 31, 2019 | Dec 31, 2018 | Change | |
|---|---------------|---------------|--------------|------|
| Alternative single family mortgages | \$ 11,415,214 | \$ 10,602,110 | \$ 813,104 | 8% |
| Prime single family mortgages | 6,813,331 | 5,496,655 | 1,316,676 | 24% |
| Other retail loans | 22,029 | 3,398 | 18,631 | 548% |
| Total Retail – on Balance Sheet | 18,250,574 | 16,102,163 | 2,148,411 | 13% |
| Conventional commercial loans | 4,039,938 | 3,871,337 | 168,601 | 4% |
| Equipment leases | 496,056 | - | 496,056 | N/A |
| Insured multi-unit residential mortgages | 3,723,785 | 3,453,192 | 270,593 | 8% |
| Total Commercial – on Balance Sheet | 8,259,779 | 7,324,529 | 935,250 | 13% |
| Total Loans – on Balance Sheet | 26,510,353 | 23,426,692 | 3,083,661 | 13% |
| Insured multi-unit residential mortgages – derecognized | 4,612,901 | 4,373,854 | 239,047 | 5% |
| Total Loans – off Balance Sheet | 4,612,901 | 4,373,854 | 239,047 | 5% |
| Total Loans Under Management | \$ 31,123,254 | \$ 27,800,546 | \$ 3,322,708 | 12% |

Table 10: On-Balance Sheet loan principal continuity schedule

| (\$ THOUSANDS, EXCEPT PERCENTAGES) | Year ended December 31, 2019 | | |
|--|------------------------------|--------------|---------------|
| | Retail | Commercial | Total |
| 2018 closing balance | \$ 16,102,163 | \$ 7,324,529 | \$ 23,426,692 |
| Originations | 5,781,058 | 4,112,811 | 9,893,869 |
| Derecognition | - | (891,723) | (891,723) |
| Net repayments | (3,632,647) | (2,285,838) | (5,918,485) |
| 2019 closing balance | \$ 18,250,574 | \$ 8,259,779 | \$ 26,510,353 |
| % Change from 2018 | 13% | 13% | 13% |
| Net repayments percentage ⁽¹⁾ | 22.6% | 31.2% | 25.3% |

| (\$ THOUSANDS, EXCEPT PERCENTAGES) | Year ended December 31, 2018 | | |
|--|------------------------------|--------------|---------------|
| | Retail | Commercial | Total |
| 2017 closing balance | \$ 13,210,550 | \$ 6,004,151 | \$ 19,214,701 |
| Originations | 5,449,864 | 3,517,055 | 8,966,919 |
| Derecognition | - | (976,085) | (976,085) |
| Net repayments | (2,558,251) | (1,220,592) | (3,778,843) |
| 2018 closing balance | \$ 16,102,163 | \$ 7,324,529 | \$ 23,426,692 |
| % Change from 2017 | 22% | 22% | 22% |
| Net repayments percentage ⁽¹⁾ | 19.4% | 20.3% | 19.7% |

⁽¹⁾ Net repayments percentage is calculated by dividing net repayments by the previous period's closing balance.

Total on-Balance Sheet loan principal increased by \$3.1 billion or 13%, driven by growth in both our Retail and Commercial businesses.

Within our Retail business, Alternative single family mortgages grew 8% due to all-time record origination volumes, and despite higher attrition levels. The rise in attrition within our Alternative single family business was largely due to a decline in our renewal rates to pre-B-20 levels since the middle of 2019. We believe that this trend results from a widened risk appetite among some larger banks as they have adjusted to the revised B-20 regulations. They appear to have been renewing our Alternative borrowers into Prime products at lower rates, which has altered our competitive dynamics. Growth in Prime single family was 24%, driven by record internal originations and a high level of originations through third parties.

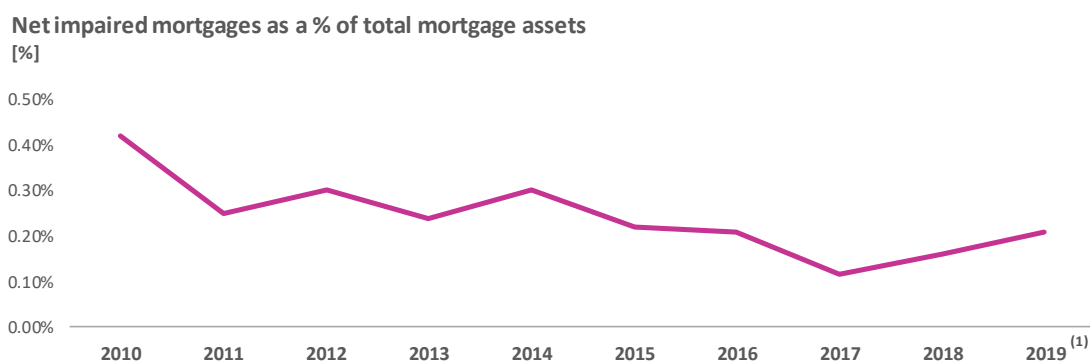
Our Commercial business also grew 13% year-over-year. Part of this growth was generated by the addition of Bennington's equipment lease portfolio at the beginning of the year. Both Conventional commercial loans and Insured Multi-unit residential mortgages grew due to strong origination volumes over the past twelve months, and despite higher unscheduled payments. Originations were slightly below 2018 levels as we deliberately constrained them in the first half of 2019 in order to rebuild our capital levels. The increase in Commercial reflects our continued success in growing the breadth and depth of our relationships with brokers and business partners.

CREDIT QUALITY AND ALLOWANCE FOR CREDIT LOSSES

Management regularly evaluates the profile of Equitable's loan portfolio and our lending practices, taking into account borrower behaviours and external variables including real estate values and economic conditions that prevail in the markets in which we lend. When management judges that the risk associated with a particular region or product is no longer acceptable, we adjust underwriting criteria to ensure that our policies continue to be prudent and reflective of current and expected economic conditions, thereby safeguarding the future health of our portfolio. When appropriate, Equitable also responds to the changing marketplace with initiatives that result in increased loan originations, while continuing to maintain a low credit-risk profile.

Impaired loans at the end of 2019 were \$122 million, up \$84 million from a year ago. Included in this balance were \$26 million of impaired equipment leases, \$17 million of which were added at the time of our Bennington acquisition. The equipment leasing business has higher expected impairment rates and losses than does our traditional mortgage business but earns a wider margin to compensate for this cost. Impaired loans also include a commercial mortgage with a principal balance of \$39 million that defaulted in Q1 2019. This loan is secured by a high-quality commercial property in Vancouver and has a current LTV of 39%, and accordingly management does not expect to realize a loss on this property. The remainder of the year-over-year increase in impaired loans was largely the result of a \$13 million net increase in defaulted Single Family Residential loans which have an average LTV of 72%.

Adjusting for the one large commercial loan, the impairment rate on our mortgage portfolio was 21 bps, up slightly from the 16 bps reported last year. The following graph highlights that even at 21 bps, our impairment rate is still at or below the levels realized in 2016 and earlier, even though it may be above the trough levels of the past two years.



⁽¹⁾ Excludes the impact of a \$39 million impaired Commercial loan that defaulted in Q1 2019 on which management does not expect to realize a loss.

Our loan credit metrics are summarized in the following table. We believe that these measures reflect the continued health of the Company's loan portfolio and indicate that our allowances adequately provide for the risk of loss.

Table 11: Loan credit metrics

| (\$ THOUSANDS, EXCEPT PERCENTAGES) | Dec 31, 2019 | Dec 31, 2018 | Change | |
|--|--------------|--------------|-----------|-------|
| Gross impaired loan assets | \$ 122,454 | \$ 38,931 | \$ 83,523 | 215% |
| Net impaired loan assets | 117,392 | 37,405 | 79,987 | 214% |
| Net impaired loan assets as a % of total loan assets | 0.44% | 0.16% | N/A | 0.28% |
| Allowance for credit losses | 36,907 | 25,298 | 11,609 | 46% |
| Allowance for credit losses as a % of total loan assets | 0.14% | 0.11% | N/A | 0.03% |
| Allowance for credit losses as a % of gross impaired loan assets | 30% | 65% | N/A | (35%) |

In aggregate, our loan portfolio remained healthy and within our risk appetite in 2019:

- Impaired loan balances grew by \$83.5 million from the previous year mainly as a result of the reasons cited above.
- The allowance for credit losses increased in both dollar terms and as a percentage of total loan assets, primarily because of a \$9.4 million allowance recorded on equipment leases in 2019. The allowance for credit losses remains sufficient in the opinion of management and well above the Company's 10-year average loss rate on its mortgage book of 2 bps.
- The allowance for credit losses as a percentage of gross impaired loan assets declined from the prior year as a result of the increase in gross impaired assets discussed above and management's belief that there will not be a corresponding increase in credit losses. This view is supported by our normal and extensive review of impaired loans, the low LTVs on our mortgages, and the quality of the collateral underpinning these loans.

LIQUIDITY INVESTMENTS AND EQUITY SECURITIES

Management believes that funding markets are currently stable and that the Company holds sufficient liquid assets. We maintain liquid asset balances at a level to ensure that we can meet our upcoming obligations even through a disruption in the financial markets.

The size and composition of our liquidity portfolio at any point in time is influenced by several factors, such as our expected future cash needs and the availability of our various funding sources. Further, we apply a strategic approach to liquidity management through rigorous asset-liability matching analysis and stress testing. Even with this liquidity risk management framework, a significant or protracted disruption to funding markets could require the Company to take further liquidity protection measures. Please refer to the Risk Management section of this document for more detail on the Company's Liquidity and Funding Risk policies and procedures.

In addition to assets that are held for the purpose of providing liquidity protection, we also maintain a portfolio of equity securities (99% of which are investment grade preferred shares) to yield tax-preferred dividend income. This portfolio could be liquidated in the event of financial stress.

Table 12: Liquid assets

| (\$ THOUSANDS, EXCEPT PERCENTAGES) | Dec 31, 2019 | Dec 31, 2018 | Change | |
|---|---------------------|---------------------|-------------------|-------------|
| Eligible deposits with regulated financial institutions ⁽¹⁾ | \$ 508,711 | \$ 472,488 | \$ 36,223 | 8% |
| Debt securities | 67,798 | 55,336 | 12,462 | 23% |
| Government of Canada issued or guaranteed debt instruments: | | | | |
| Investments purchased under reverse repurchase agreements | 150,069 | 250,000 | (99,931) | (40%) |
| Loans and investments held in the form of debt securities ⁽²⁾ , net of obligations under repurchase agreements | 848,719 | 502,015 | 346,704 | 69% |
| Liquid assets held for regulatory purposes | 1,575,297 | 1,279,839 | 295,458 | 23% |
| Other deposits with regulated financial institutions | 142 | 4,755 | (4,613) | (97%) |
| Equity securities ⁽³⁾ | 114,898 | 121,998 | (7,100) | (6%) |
| Total | \$ 1,690,337 | \$ 1,406,592 | \$ 283,745 | 20% |
| Liquid assets held for regulatory purposes as a % of total | | | | |
| Equitable Bank assets | 5.5% | 5.1% | N/A | 0.4% |
| Total liquid assets as a % of total assets | 6.0% | 5.6% | N/A | 0.4% |

⁽¹⁾ Eligible deposits with regulated financial institutions represents deposits of Equitable Bank which are held with major Canadian financial institutions and excludes \$8.4 million (December 31, 2018 – \$6.9 million) of restricted cash held as collateral with third parties for the Company's interest rate swap transactions and \$454.6 million (December 31, 2018 – \$320.2 million) of cash held in trust accounts and deposits held with banks as collateral for the Company's securitization activities.

⁽²⁾ Loans held in the form of debt securities represent loans securitized and retained by the Company and are reported in our Loans receivable balances. Investments held in the form of debt securities refer to MBS securities that we purchase from third parties. These values reported above represent the fair market value of the associated MBS securities.

⁽³⁾ Equity securities include publicly traded common and preferred shares and exclude privately held investments.

To ensure institutions have sufficient high-quality liquid assets to survive a significant stress scenario lasting 30 calendar days, OSFI has mandated that Canadian deposit-taking institutions monitor and report their Liquidity Coverage Ratio ("LCR")⁽¹⁾. At December 31, 2019, our LCR was well in excess of the regulatory minimum of 100%.

Liquid asset balances were \$1.7 billion at year end, up \$0.3 billion from last year. The higher level of liquid asset holdings reflects growth in our commitment pipeline and our expected cash flow needs in the coming quarters.

⁽¹⁾ See Non-Generally Accepted Accounting Principles Financial Measures section of this MD&A.

OTHER ASSETS

Please refer to Note 14 to our 2019 audited annual consolidated financial statements for details of our Other assets balances at December 31, 2019 and 2018.

Other assets were \$161.1 million at December 31, 2019, an increase of \$13.4 or 9% over last year. Overall, the increase in Other assets was mainly due to:

- \$19.5 million increase in Intangible assets, primarily due to the consolidation of Bennington, investments in various projects over the past twelve months including our cloud migration, and our AIRB implementation;
- \$16.9 million of goodwill recorded in relation to the Bennington acquisition;
- \$13.6 million of Right-of-use assets added to the balance sheet as a result of our IFRS 16 implementation;
- \$4.6 million increase in receivables relating to securitization activities; and
- \$5.1 million increase in the fair value of outstanding derivative financial instruments;

Offset by:

- \$44.1 million decrease in Prepaid expenses and other, mainly due to the release of escrowed funds that we set aside last December for the acquisition of Bennington on January 1, 2019; and
- \$1.5 million decrease in Deferred costs – Contingent liquidity facility as a result of amortization recorded during the past four quarters, offset in part by the upfront costs incurred when we renewed the facility in June of this year.

DEPOSITS

Equitable Bank is a federally regulated deposit taking institution and offers deposits eligible for CDIC insurance to savers across Canada under the Equitable Bank and *EQ Bank* brands. Our deposit product suite, which includes GICs, HISAs, and deposit notes, provides a reliable and diversified base of funding that can be effectively matched against loan maturities. Equitable Bank sources deposits through a national distribution network of third party deposit agents, financial advisors, and strategic distribution partners. *EQ Bank*, a digital first banking platform, further diversifies our funding sources and builds direct relationships with Canadian savers. *EQ Bank* is a key strategic pillar for us as *Canada's Challenger Bank™*.

Table 13: Deposit principal

| (\$ THOUSANDS) | Dec 31, 2019 | Dec 31, 2018 | Change | |
|--------------------------|---------------|---------------|--------------|-------|
| Brokered deposits: | | | | |
| Term | \$ 11,056,440 | \$ 10,345,979 | \$ 710,461 | 7% |
| Demand | 557,211 | 679,147 | (121,936) | (18%) |
| | 11,613,651 | 11,025,126 | 588,525 | 5% |
| <i>EQ Bank</i> deposits: | | | | |
| Term | 516,195 | 753,687 | (237,492) | (32%) |
| Demand | 2,150,356 | 1,434,494 | 715,862 | 50% |
| | 2,666,551 | 2,188,181 | 478,370 | 22% |
| Strategic partnerships | 602,970 | 158,705 | 444,265 | 280% |
| Deposit notes | 348,716 | 150,000 | 198,716 | 132% |
| Total | \$ 15,231,888 | \$ 13,522,012 | \$ 1,709,876 | 13% |

Total deposit principal increased by \$1.7 billion or 13% over 2018, in line with the growth rate of our mortgage portfolio. The increase in deposits was driven by growth across almost all funding sources, demonstrating our success in driving funding diversification.

Brokered term deposits increased by \$710 million or 7% over the last year as we continue to demonstrate the strength of our relationships with deposit agents and brokers. Our distribution network remains as broad as that of any non-big 6 bank.

Also contributing to the growth of our deposits was our award-winning *EQ Bank* platform. Balances grew to a record level of \$2.7 billion, up \$478 million or 22% from a year ago. The increase in *EQ Bank* deposits was driven by our growing customer base which expanded by 35% to over 95,000 customers at the end of 2019. We expect to continue growing our customer base and balances as we enhance the platform by adding more services, maintain a highly competitive deposit rate, provide superior service, and market the unique benefits of the *Savings Plus* account.

We continued to strengthen our funding profile by deepening our Strategic deposit distribution partnerships. These more stable deposits almost quadrupled to \$603 million over the past twelve months. These partnerships demonstrate the success of our distribution strategy, have allowed us to reach new customers across Canada, and further diversify our deposit sources.

Brokered demand deposits remain a small share of our overall funding base as a result of our previous decision to de-emphasize their growth. We may choose to grow these balances modestly in the future given that they are highly cost effective, and if we do so will ensure that we have the frameworks and liquid asset position to suitably manage the associated risks.

We are also committed to building our deposit note program over the long-term. During the year, the maturity of a \$150 million deposit note was offset by the successful closing of two fixed-rate deposit note issuances of \$150 million and \$200 million. The notes issued rank equally and ratably with all present and future unsecured and unsubordinated liabilities of the Company, were priced at 160 bps and 145 bps over comparable term Government of Canada bonds, and attracted broad investor participation.

SECURITIZATION LIABILITIES

A large portion of the Company's securitization transactions do not qualify the loans for balance sheet derecognition and therefore the associated obligations are recognized on the consolidated balance sheets and accounted for as securitization liabilities. The Securitization liability was \$10.7 billion at the end of December 31, 2019, up \$1.5 billion or 16% from last year. The increase is largely due to the growth of our Prime Single Family assets and the addition of \$160 million of liabilities associated with securitized equipment leases acquired as part of the Bennington acquisition. Our securitization liability also included \$750 million (December 31, 2018 – \$810 million) of securitizations through a funding program which is sponsored by a major Canadian Schedule I Bank and provides Equitable with a source of matched funding for qualifying uninsured single family mortgages.

BANK FACILITIES

The Bank has two revolving credit facilities with major Schedule I Canadian banks to fund insured residential mortgages prior to securitization, with an aggregate capacity of \$600 million (December 31, 2018 – \$600 million). At December 31, 2019, there was no balance outstanding on the facilities (December 31, 2018 – \$290 million). Our use of these facilities is a function of our Prime Single Family and Multi activity levels, the timing of mortgage securitizations and sales, and the availability of other funding sources.

We also have a \$35 million operating credit facility in place with a major Canadian Schedule I Bank. The facility is secured by a portion of the Company's preferred share investments. There was no outstanding balance on the facility at December 31, 2019 or 2018.

In Q2 2019, the Company reduced the size of its secured backstop funding facility obtained from a syndicate of the major Canadian banks to \$400 million from \$850 million and successfully renewed the facility for an additional 2 years. The new terms of the facility include a 0.1% commitment fee, a 0.55% standby fee on any unused portion of the facility, and an interest rate on the drawn portion of the facility equal to 3 month CDOR plus 1.25%. No advances have been made on this facility.

Details related to the Company's bank facilities can be found in Note 18 to our 2019 audited consolidated financial statements.

OTHER LIABILITIES AND DEFERRED INCOME TAXES

Please refer to Notes 16(b) and 17 to our 2019 audited consolidated financial statements for a detailed breakdown of Net deferred income tax liabilities and Other liabilities as at December 31, 2019 and December 31, 2018.

Other liabilities and Net deferred income tax liabilities, on an aggregate basis, increased by \$48.0 million or 22% to \$268.5 million. Bennington contributed \$31.3 million to this increase. Overall, the increase was mainly driven by:

- \$21.1 million increase in Income taxes payable;
- \$15.5 million Right-of-use liabilities recorded as a result of the IFRS 16 implementation;
- \$12.1 million increase in net deferred income tax liabilities; and
- \$7.7 million increase in Accounts payable and accrued liabilities, as a result of consolidating Bennington, partly offset by a decrease in other liabilities associated with our Maple Assets;

Offset by:

- \$8.3 million decrease in Loan realty taxes mainly resulted from the refund of the tax amount collected from the borrower in excess of the tax remitted.

Contractual obligations by year of maturity are outlined in Table 30 – Contractual obligations. There were no material changes to contractual obligations that are outside the ordinary course of the Company's operations during 2019.

SHAREHOLDERS' EQUITY

Total shareholders' equity increased \$187.7 million or 15% to \$1.5 billion at December 31, 2019, from \$1.3 billion a year ago. The increase reflects the earnings retained by the Company, net of dividends paid and fair value losses on certain preferred share holdings and derivative hedges associated with securitization activity.

At December 31, 2019, the Company had 16,797,593 common shares and 3,000,000 Series 3 preferred shares issued and outstanding (December 31, 2018 – 16,554,018 common shares and 3,000,000 Series 3 preferred shares).

During 2019, 144,967 options were granted. In addition, 220,364 stock options were exercised that contributed \$9.1 million to common share capital. At December 31, 2019, there were 577,012 unexercised stock options, which are, or will be, exercisable to purchase common shares for maximum proceeds of \$35.1 million. For additional information on outstanding stock options and their associated exercise prices, please refer to Note 20(a) to the 2019 audited consolidated financial statements.

CAPITAL MANAGEMENT – EQUITABLE BANK

We manage the Bank's capital in accordance with guidelines established by OSFI, based on standards issued by the Bank for International Settlements' Basel Committee on Banking Supervision ("BCBS"). OSFI's Capital Adequacy Requirements ("CAR") Guideline details how Basel III rules apply to Canadian banks. OSFI has mandated that all Canadian-regulated financial institutions meet target Capital Ratios: those being a CET1 Ratio of 7.0%, a Tier 1 Capital Ratio of 8.5%, and a Total Capital Ratio of 10.5%. In order to govern the quality and quantity of capital necessary based on the Bank's inherent risks, Equitable Bank utilizes an Internal Capital Adequacy Assessment Process ("ICAAP").

Management believes that the Bank's current level of capital and earnings in future periods will be sufficient to support our strategic objectives and ongoing growth. Equitable Bank's Capital Ratios at December 31, 2019 exceeded the regulatory minimums and were within our target range. Our Capital Ratios were up slightly from last year due to organic growth in our

capital driven by high levels of earnings retention. Risk-weighted assets grew more slowly partly due to our deliberate decision to reduce commercial originations in the first half of the year, and despite the acquisition of Bennington.

Canadian banks are required to report on OSFI's Leverage Ratio based on Basel III guidelines. OSFI has established minimum Leverage Ratio targets on a confidential and institution-by-institution basis. Equitable Bank's Leverage Ratio was 4.9% at December 31, 2019 and the Bank remains fully compliant with its regulatory requirements. Our Leverage Ratio decreased relative to 2018 as a result of the Bennington acquisition and the high growth in our insured Prime single family assets.

As part of our capital management process, we stress test the loan portfolio on a regular basis in order to understand the potential impact of extreme but plausible adverse economic scenarios. We use these tests to analyze the impact that an increase in unemployment, rising interest rates, a decline in real estate prices, and other factors could have on our financial position. Based on the results of the stress tests performed to date, we have determined that even in the most adverse scenario analyzed, the Company has sufficient capital to absorb the potential losses without impairing the viability of the institution and that we would remain profitable in each year of the testing horizon.

Table 14: Capital measures of Equitable Bank

| (\$ THOUSANDS, EXCEPT PERCENTAGES) | Dec 31, 2019 | Dec 31, 2018 | Change | |
|---|--------------|--------------|----------|--------|
| Total risk-weighted assets ("RWA") | \$ 9,761,287 | \$ 8,802,891 | 958,396 | 11% |
| Common Equity Tier 1 Capital: | | | | |
| Common shares | 213,995 | 203,270 | 10,725 | 5% |
| Contributed surplus | 8,065 | 8,127 | (62) | (1%) |
| Retained earnings | 1,191,562 | 1,011,052 | 180,510 | 18% |
| Accumulated other comprehensive income/(loss) ("AOCI") ⁽¹⁾ | (18,827) | (17,565) | (1,262) | 7% |
| Less: Regulatory adjustments to Common Equity Tier 1 Capital | (66,591) | (20,684) | (45,907) | 222% |
| Common Equity Tier 1 Capital | 1,328,204 | 1,184,200 | 144,004 | 12% |
| Additional Tier 1 capital: | | | | |
| Non-cumulative preferred shares | 72,554 | 72,554 | - | 0% |
| Tier 1 Capital | 1,400,758 | 1,256,754 | 144,004 | 11% |
| Tier 2 Capital: | | | | |
| Eligible Stage 1 and 2 allowance | 31,844 | 23,772 | 8,072 | 34% |
| Tier 2 Capital | 31,844 | 23,772 | 8,072 | 34% |
| Total Capital | \$ 1,432,602 | \$ 1,280,526 | 152,076 | 12% |
| Capital Ratios: | | | | |
| CET1 Ratio | 13.6% | 13.5% | N/A | 0.1% |
| Tier 1 Capital Ratio | 14.4% | 14.3% | N/A | 0.1% |
| Total Capital Ratio | 14.7% | 14.5% | N/A | 0.2% |
| Leverage Ratio | 4.9% | 5.0% | N/A | (0.1%) |

⁽¹⁾ As prescribed by OSFI (under Basel III rules), AOCI is part of the CET1 in its entirety, however, the amount of cash flow hedge reserves that relate to the hedging of items that are not fair valued is excluded.

Table 15: Risk-weighted assets of Equitable Bank

| (\$ THOUSANDS, EXCEPT PERCENTAGES) | Dec 31, 2019 | | |
|--|--------------|----------------|-----------------------|
| | Amounts | Risk Weighting | Risk-weighted Amounts |
| On balance sheet: | | | |
| Cash and cash equivalents | \$ 971,703 | 17% | \$ 164,082 |
| Securities purchased under reverse repurchase agreements | 150,069 | 0% | - |
| Investments | 362,611 | 38% | 137,525 |
| Loans – Retail | 18,365,516 | 21% | 3,864,649 |
| Loans – Commercial | 8,274,158 | 50% | 4,111,203 |
| Securitization retained interests | 139,009 | 100% | 139,009 |
| Other assets | 161,085 | 49% | 79,021 |
| Total Equitable Bank assets subject to risk rating | 28,424,151 | | 8,495,489 |
| Less: Eligible Stage 1 and 2 allowance | (31,844) | | - |
| Total Equitable Bank assets | 28,392,307 | | 8,495,489 |
| Off-balance sheet: | | | |
| Loan commitments | | | 462,033 |
| Derivatives | | | 22,942 |
| Other | | | 16,360 |
| Total credit risk | | | 8,996,824 |
| Operational risk ⁽¹⁾ | | | 764,463 |
| Total | | | \$ 9,761,287 |
| <hr/> | | | |
| (\$ THOUSANDS, EXCEPT PERCENTAGES) | Dec 31, 2018 | | |
| | Amounts | Risk Weighting | Risk-weighted Amounts |
| On balance sheet: | | | |
| Cash and cash equivalents | \$ 799,586 | 17% | \$ 135,935 |
| Securities purchased under reverse repurchase agreements | 250,000 | 0% | - |
| Investments | 193,399 | 78% | 150,364 |
| Loans – Retail | 16,207,157 | 22% | 3,486,522 |
| Loans – Commercial | 7,343,019 | 50% | 3,668,727 |
| Securitization retained interests | 115,331 | 100% | 115,331 |
| Other assets | 147,671 | 78% | 114,908 |
| Total Equitable Bank assets subject to risk rating | 25,056,163 | | 7,671,787 |
| Less: Eligible Stage 1 and 2 allowance | (23,772) | | - |
| Total Equitable Bank assets | 25,032,391 | | 7,671,787 |
| Off-balance sheet: | | | |
| Loan commitments | | | 446,688 |
| Derivatives | | | 39,091 |
| Total credit risk | | | 8,157,566 |
| Operational risk ⁽¹⁾ | | | 645,325 |
| Total | | | \$ 8,802,891 |

⁽¹⁾ For operational risk, Equitable Bank uses the Basic Indicator Approach – calculated as 15% of the previous three-year average of net interest income and other income, excluding gain or loss on investments. The risk-weighted equivalent is determined by multiplying the capital requirement for operational risk by 12.5.

SUMMARY OF QUARTERLY RESULTS

The following table summarizes the Company's performance over the last eight quarters. Equitable does not typically experience material seasonality in its earnings, but changes in loan prepayment income, and fair value of our security investments and hedging activities may cause some volatility in earnings from quarter to quarter.

Table 16: Summary of quarterly results

| (\$ THOUSANDS, EXCEPT SHARE, PER SHARE AMOUNTS AND PERCENTAGES) | 2019 | | | | 2018 | | | |
|---|------------|------------|------------|------------|------------|------------|------------|------------|
| | Q4 | Q3 | Q2 | Q1 | Q4 | Q3 | Q2 | Q1 |
| RESULTS OF OPERATIONS | | | | | | | | |
| Net income | \$ 55,854 | \$ 54,942 | \$ 54,022 | \$ 41,661 | \$ 40,116 | \$ 47,806 | \$ 37,537 | \$ 40,167 |
| Adjusted net income | 56,045 | 54,754 | 54,512 | 46,579 | 45,535 | 45,662 | 41,510 | 40,071 |
| Net income available to common shareholders | 54,736 | 53,751 | 52,831 | 40,470 | 38,926 | 46,615 | 36,346 | 38,976 |
| NII | 124,827 | 118,147 | 114,322 | 105,352 | 94,591 | 93,024 | 79,496 | 81,270 |
| Total revenue | 302,822 | 293,285 | 283,625 | 271,494 | 239,568 | 232,410 | 214,958 | 200,786 |
| EPS – basic ⁽¹⁾ | 3.27 | 3.22 | 3.17 | 2.44 | 2.35 | 2.82 | 2.20 | 2.36 |
| EPS – diluted ⁽¹⁾ | 3.21 | 3.18 | 3.15 | 2.42 | 2.33 | 2.80 | 2.19 | 2.34 |
| Adjusted EPS – diluted ⁽¹⁾ | 3.22 | 3.17 | 3.18 | 2.72 | 2.66 | 2.67 | 2.43 | 2.34 |
| ROE | 15.9% | 16.2% | 16.8% | 13.4% | 12.9% | 15.9% | 13.0% | 14.5% |
| Adjusted ROE | 15.9% | 16.2% | 16.9% | 15.0% | 14.7% | 15.2% | 14.4% | 14.5% |
| Return on average assets | 0.8% | 0.8% | 0.8% | 0.7% | 0.7% | 0.8% | 0.7% | 0.8% |
| NIM | 1.78% | 1.75% | 1.76% | 1.67% | 1.58% | 1.66% | 1.50% | 1.60% |
| Efficiency Ratio | 40.6% | 39.5% | 39.5% | 41.1% | 41.7% | 36.5% | 43.2% | 37.9% |
| BALANCE SHEET | | | | | | | | |
| Total assets | 28,392,452 | 27,544,976 | 26,361,201 | 26,327,464 | 25,037,145 | 23,147,614 | 21,944,721 | 21,054,763 |
| AUM | 33,005,353 | 32,333,820 | 30,909,183 | 30,830,162 | 29,410,999 | 27,495,398 | 26,142,735 | 25,259,152 |
| Loans receivable | 26,607,830 | 25,960,054 | 24,867,909 | 24,446,452 | 23,526,404 | 21,671,338 | 20,455,377 | 19,676,690 |
| LUM | 31,123,254 | 30,640,893 | 29,321,091 | 28,848,831 | 27,800,546 | 25,935,686 | 24,568,457 | 23,794,216 |
| Preferred Shares | 72,557 | 72,557 | 72,557 | 72,557 | 72,557 | 72,557 | 72,557 | 72,557 |
| Common shareholders' equity | 1,395,157 | 1,338,965 | 1,287,089 | 1,241,411 | 1,207,470 | 1,187,318 | 1,140,395 | 1,108,915 |
| Liquid assets | 1,690,337 | 1,431,940 | 1,592,125 | 2,046,896 | 1,406,592 | 1,439,394 | 1,782,905 | 1,775,459 |
| CREDIT QUALITY | | | | | | | | |
| PCL | 3,917 | 3,463 | 1,386 | 9,628 | 628 | 517 | 168 | 770 |
| PCL – rate | 0.06% | 0.05% | 0.02% | 0.16% | 0.01% | 0.01% | 0.003% | 0.02% |
| Net impaired loans as a % of total loan assets | 0.44% | 0.47% | 0.42% | 0.49% | 0.16% | 0.16% | 0.13% | 0.13% |
| Allowance for credit losses as a % of total loan assets | 0.14% | 0.13% | 0.13% | 0.13% | 0.11% | 0.11% | 0.12% | 0.13% |

⁽¹⁾ Annual EPS may not equal to the sum of quarterly EPS as a result of rounding and the computation of the in-the-money options for the year versus the quarter.

Table 16: Summary of quarterly results (continued)

| (\$ THOUSANDS, EXCEPT SHARE, PER SHARE AMOUNTS AND PERCENTAGES) | 2019 | | | | 2018 | | | |
|---|-------------------|------------|------------|------------|------------|------------|------------|------------|
| | Q4 | Q3 | Q2 | Q1 | Q4 | Q3 | Q2 | Q1 |
| SHARE CAPITAL | | | | | | | | |
| Common shares outstanding | | | | | | | | |
| Weighted average basic | 16,756,323 | 16,705,416 | 16,650,635 | 16,573,522 | 16,553,212 | 16,528,351 | 16,517,020 | 16,507,603 |
| Weighted average diluted | 17,031,780 | 16,920,557 | 16,770,276 | 16,702,520 | 16,672,512 | 16,654,209 | 16,603,186 | 16,629,832 |
| Book value per common share | 83.06 | 79.97 | 77.22 | 74.59 | 72.94 | 71.73 | 69.03 | 67.14 |
| Common share price – close | 109.35 | 103.81 | 72.59 | 64.73 | 59.12 | 68.87 | 59.56 | 53.68 |
| Common share market capitalization | 1,836,817 | 1,738,117 | 1,209,850 | 1,077,281 | 978,674 | 1,140,013 | 983,968 | 886,538 |
| Dividends declared per: ⁽¹⁾ | | | | | | | | |
| Common share | 0.35 | 0.33 | 0.31 | 0.30 | 0.28 | 0.27 | 0.27 | 0.26 |
| Preferred share – Series 3 | 0.37 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 |
| EQUITABLE BANK CAPITAL RATIOS | | | | | | | | |
| CET1 Ratio | 13.6% | 13.3% | 13.1% | 12.9% | 13.5% | 13.8% | 14.3% | 14.7% |
| Tier 1 Capital Ratio | 14.4% | 14.1% | 13.9% | 13.7% | 14.3% | 14.7% | 15.3% | 15.7% |
| Total Capital Ratio | 14.7% | 14.4% | 14.2% | 14.0% | 14.5% | 15.0% | 15.6% | 16.0% |
| Leverage Ratio | 4.9% | 4.8% | 4.9% | 4.7% | 5.0% | 5.3% | 5.4% | 5.5% |

⁽¹⁾ Annual dividends declared per share may not equal the sum of the quarterly dividends per share due to rounding.

FOURTH QUARTER OVERVIEW

Equitable produced all-time record quarterly earnings in Q4 2019, demonstrating the value of our strategy and establishing a strong foundation for 2020. Adjusted EPS for the quarter was \$3.22, \$0.05 and \$0.56 higher than Q3 2019 and Q4 2018, respectively. Adjusted earnings exclude the negative impact of mark-to-market losses on certain security investments and derivatives transactions. Reported EPS for the quarter was \$3.21, compared to \$3.18 in Q3 2019 and \$2.33 in the same period of last year.

ITEMS OF NOTE

There were no items of note in our financial results for Q4 2019 or Q3 2019.

Q4 2018 financial results were impacted by the following item, on a pre-tax basis:

- \$7.4 million of mark-to-market losses on certain preferred share investments and derivative financial instruments related to securitization activities.

NET INTEREST INCOME

The table below details the Company's NII and NIM for the three months ended December 31, 2019, with comparisons to the prior quarter and the corresponding quarter of the prior year, by product and portfolio.

Table 17: Net interest income

| (\$ THOUSANDS, EXCEPT PERCENTAGES) | Three months ended | | | | | |
|---|---------------------|-----------------|---------------------|-----------------|---------------------|-----------------|
| | Dec 31, 2019 | | Sep 30, 2019 | | Dec 31, 2018 | |
| | Revenue/ Expense | Average Rate | Revenue/ Expense | Average Rate | Revenue/ Expense | Average rate |
| <i>Revenues derived from:</i> | | | | | | |
| Cash and equivalents | \$ 7,894 | 2.04% | \$ 7,319 | 1.94% | \$ 5,124 | 1.84% |
| Equity securities ⁽¹⁾ | 1,505 | 4.89% | 1,705 | 5.66% | 1,615 | 4.48% |
| Alternative single family mortgages | 141,065 | 4.94% | 138,443 | 4.90% | 121,683 | 4.65% |
| Prime single family mortgages | 41,186 | 2.42% | 37,447 | 2.43% | 29,516 | 2.29% |
| Other retail loans | 273 | 5.66% | 192 | 5.86% | 39 | 6.19% |
| Total Retail loans | 182,524 | 4.00% | 176,082 | 4.03% | 151,238 | 3.87% |
| Conventional commercial loans | 57,824 | 6.03% | 58,208 | 5.98% | 54,183 | 5.80% |
| Equipment leases | 14,215 | 11.58% | 13,128 | 11.05% | N/A | N/A |
| Insured multi-unit residential mortgages | 29,507 | 3.16% | 27,141 | 3.07% | 27,876 | 3.30% |
| Total Commercial loans | 101,546 | 5.04% | 98,477 | 4.98% | 82,059 | 4.61% |
| Average interest earning assets | 293,469 | 4.20% | 283,583 | 4.20% | 240,036 | 4.00% |
| <i>Expenses related to:</i> | | | | | | |
| Deposits | 99,385 | 2.63% | 97,169 | 2.64% | 84,432 | 2.54% |
| Secured backstop funding facility | 625 | N/A | 632 | N/A | 2,273 | N/A |
| Securitization liabilities | 65,950 | 2.49% | 64,858 | 2.55% | 55,898 | 2.56% |
| Others | 2,682 | 2.07% | 2,777 | 2.02% | 2,842 | 2.32% |
| Average interest bearing liabilities | 168,642 | 2.57% | 165,436 | 2.60% | 145,445 | 2.59% |
| Net interest income and margin | \$ 124,827 | 1.78% | \$ 118,147 | 1.75% | \$ 94,591 | 1.58% |

⁽¹⁾ Effective January 1, 2019, the revenues from Equity securities are presented excluding a TEB adjustment. Prior period comparatives have been restated.

Q4 2019 v Q4 2018

NII was up 32% year-over-year mainly driven by 17% growth in our average asset balances and a 20 bp increase in our NIM.

Table 18(a): Factors affecting Q4 2019 v Q4 2018 NIM

| | Impact (in bps) | Drivers of change |
|--------------------------------|-----------------|---|
| Equipment leases | 11 | • Addition of higher spread equipment leases acquired in Q1 2019 |
| Rates/spread ⁽¹⁾ | 11 | • Higher spreads on our recent Retail and Commercial lending portfolios |
| Backstop funding facility fees | 3 | • Fees associated with our downsized and lower cost secured backstop funding facility |
| Business mix | (10) | • Mix shift toward lower spread Prime mortgages, which have experienced higher growth since late 2018 |
| Loan prepayment income | 3 | • Higher level of early discharges in Alternative Single Family |
| Other | 2 | |
| Change in Total NIM | 20 | |

⁽¹⁾ The rate effect is calculated after adjusting for the impact of business mix changes.

Q4 2019 v Q3 2019

NII increased 6% from last quarter as a result of asset growth and a 3 bp increase in NIM.

Table 18(b): Factors affecting Q4 2019 v Q3 2019 NIM

| | Impact (in bps) | Drivers of change |
|-----------------------------|-----------------|---|
| Rates/spread ⁽¹⁾ | 5 | • High spreads on recent Retail lending originations |
| Business mix | (3) | • Mix shift toward lower spread Prime mortgages |
| Loan prepayment income | 2 | • Slightly higher levels of early discharges in Alternative Single Family |
| Other | (1) | |
| Change in Total NIM | 3 | |

⁽¹⁾ The rate effect is calculated after adjusting for the impact of business mix changes.

PROVISION FOR CREDIT LOSSES

Table 19: Provision for credit losses

| (\$ THOUSANDS, EXCEPT PERCENTAGES) | Dec 31, 2019 | | | Sep 30, 2019 | Change | Three months ended | |
|------------------------------------|--------------|------------|--------------|--------------|--------|--------------------|--------|
| | Equitable | Bennington | Consolidated | | | Dec 31, 2018 | Change |
| Stage 1 and 2 provision | \$ 742 | \$ 432 | \$ 1,174 | \$ 1,020 | 15% | \$ 73 | 1,508% |
| Stage 3 provision | 196 | 2,547 | 2,743 | 2,443 | 12% | 555 | 394% |
| PCL | \$ 938 | \$ 2,979 | \$ 3,917 | \$ 3,463 | 13% | \$ 628 | 524% |
| PCL – rate | 0.01% | 2.42% | 0.06% | 0.05% | 0.01% | 0.01% | 0.05% |

Q4 2019 v Q4 2018

The Company's provision for credit losses during the fourth quarter was \$3.9 million, \$3.3 million higher than Q4 of last year. The increase was primarily driven by \$3.0 million of provisions related to the lease portfolio that we acquired in 2019.

Q4 2019 v Q3 2019

The Provision for credit losses increased in Q4 relative to the preceding quarter by \$0.5 million or 13%, mainly as a result of an increase in Stage 3 provisions against impaired equipment leases. This increase was partly offset by a decrease in provisions on our mortgage portfolio.

OTHER INCOME

Table 20: Other income

| (\$ THOUSANDS) | Three months ended | | | | |
|---|--------------------|--------------|--------|--------------|--------|
| | Dec 31, 2019 | Sep 30, 2019 | Change | Dec 31, 2018 | Change |
| Fees and other income | | | | | |
| Fees and other income | \$ 5,941 | \$ 5,812 | 2% | \$ 3,776 | 57% |
| Income from successor issuer activities | 260 | 298 | (13%) | 686 | (62%) |
| Net gain (loss) on investments | 99 | (327) | 130% | (3,754) | 103% |
| Securitization activities: | | | | | |
| Gains on securitization and income from retained interests | 3,108 | 3,337 | (7%) | 2,442 | 27% |
| Fair value (losses) gains on derivative financial instruments | (55) | 582 | (109%) | (3,618) | 98% |
| Total | \$ 9,353 | \$ 9,702 | (4%) | \$ (468) | 2,099% |

Q4 2019 v Q4 2018

Other income was up \$9.8 million compared with Q4 2018, mainly because of:

- Lower net fair value losses on certain security investments and derivative financial instruments;
- An increase in Fees and other income, primarily from Bennington's equipment lease portfolio; and
- Higher Gains on securitization and income from retained interest, driven by higher gain on sale margin and despite lower derecognition volumes.

Q4 2019 v Q3 2019

Other income decreased slightly by \$0.3 million or 4% mainly due to negative quarter-over-quarter changes in Fair value on derivative financial instruments.

NON-INTEREST EXPENSES

Table 21: Non-interest expenses and Efficiency Ratio

| (\$ THOUSANDS, EXCEPT PERCENTAGES AND FTE) | Three months ended | | | | |
|--|--------------------|--------------|--------|--------------|--------|
| | Dec 31, 2019 | Sep 30, 2019 | Change | Dec 31, 2018 | Change |
| Compensation and benefits | \$ 25,920 | \$ 25,696 | 1% | \$ 20,021 | 29% |
| Technology and system costs | 8,976 | 8,254 | 9% | 5,858 | 53% |
| Marketing and corporate expenses | 7,724 | 4,801 | 61% | 3,830 | 102% |
| Regulatory, legal and professional fees | 5,261 | 5,136 | 2% | 4,303 | 22% |
| Product costs | 4,453 | 4,339 | 3% | 3,372 | 32% |
| Premises | 2,143 | 2,263 | (5%) | 1,849 | 16% |
| Total | \$ 54,477 | \$ 50,489 | 8% | \$ 39,233 | 39% |
| Efficiency Ratio ⁽¹⁾ | 40.6% | 39.5% | 1.1% | 41.7% | (1.1%) |
| FTE – period average | 857 | 839 | 2% | 665 | 29% |

⁽¹⁾ Effective January 1, 2019, Efficiency Ratio is presented excluding a TEB adjustment. Prior period comparatives have been restated.

Overall, non-interest expenses were \$4.0 million or 8% higher than in the prior quarter and up \$15.2 million or 39% from a year ago. Bennington contributed \$6.1 million of expenses in the quarter, \$3.3 million of which related to compensation and benefits.

Q4 2019 v Q4 2018

Despite general cost growth and the inclusion of the Bennington business, which operates with an Efficiency Ratio of approximately 55%, our overall Efficiency Ratio decreased to 40.6% from 41.7% a year ago as growth in our net revenue outpaced the increase in expenses. Net revenue in Q4 2018 was negatively impacted by mark-to-market losses on certain of our security investments and derivative transactions, and caused our Efficiency Ratio to spike to an unusually high level.

Total expenses, excluding Bennington's operating costs, were up by \$9.1 million or 23% mainly due to:

- Higher Compensation and benefits costs, which were largely the result of an 8% increase in FTE, annual salary adjustments, and incentive payouts;
- An increase in Marketing expenses related to both an *EQ Bank* multimedia (OOH, Digital, TV) "account that gives you more" campaign as well as an *EQ Bank* international money transfer digital launch campaign; and
- Higher Technology and systems costs as a result of our cloud migration project and continued investments in development and advancement of our core banking systems. With respect to cloud related infrastructure costs, we expect our spending will reduce by approximately \$1.2 million in Q1 2020 due to the completion of migration in this quarter.

Q4 2019 v Q3 2019

Excluding Bennington's costs, expenses were up \$3.7 million or 8%, primarily because Technology and system costs and Marketing expenses increased for the reasons cited above.

INCOME TAXES

Q4 2019 v Q4 2018

Our effective income tax rate increased to 26.3% from 26.0% a year ago primarily because of lower tax-exempt dividend income.

Q4 2019 v Q3 2019

Our effective income tax rate for the quarter increased by 0.6% compared to 25.7% in the preceding quarter, primarily due to an adjustment for a rate reduction enacted in Alberta and recorded in Q3 2019.

TOTAL LOAN PRINCIPAL

The following table provides quarterly on-balance sheet loan principal continuity schedules by lending business for Q4 2019 and Q4 2018:

Table 22: On-Balance Sheet loan principal continuity schedule

| (\$ THOUSANDS, EXCEPT PERCENTAGES) | Three months ended December 31, 2019 | | |
|--|--------------------------------------|--------------|---------------|
| | Retail | Commercial | Total |
| Q3 2019 closing balance | \$ 17,947,471 | \$ 7,904,578 | \$ 25,852,049 |
| Originations | 1,490,234 | 1,209,247 | 2,699,481 |
| Derecognition | - | (181,962) | (181,962) |
| Net repayments | (1,187,131) | (672,084) | (1,859,215) |
| Q4 2019 closing balance | \$ 18,250,574 | \$ 8,259,779 | \$ 26,510,353 |
| % Change from Q3 2019 | 2% | 4% | 3% |
| Net repayments percentage ⁽¹⁾ | 6.6% | 8.5% | 7.2% |

| (\$ THOUSANDS, EXCEPT PERCENTAGES) | Three months ended December 31, 2018 | | |
|--|--------------------------------------|--------------|---------------|
| | Retail | Commercial | Total |
| Q3 2018 closing balance | \$ 14,609,034 | \$ 6,978,868 | \$ 21,587,902 |
| Originations | 2,130,779 | 962,228 | 3,093,007 |
| Derecognition | - | (300,696) | (300,696) |
| Net repayments | (637,650) | (315,871) | (953,521) |
| Q4 2018 closing balance | \$ 16,102,163 | \$ 7,324,529 | \$ 23,426,692 |
| % Change from Q3 2018 | 10% | 5% | 9% |
| Net repayments percentage ⁽¹⁾ | 4.4% | 4.5% | 4.4% |

⁽¹⁾ Net repayments percentage is calculated by dividing net repayments by the previous period's closing balance.

Q4 2019 v Q4 2018

Please refer to page 29 of this document for a discussion of our year-over-year portfolio growth.

Q4 2019 v Q3 2019

During the quarter, total loan principal increased by \$658 million due to growth in both our Retail and Commercial businesses.

The growth in our Retail portfolio was primarily driven by an increase in our Prime portfolio, helped by the strong internal originations and \$312 million of mortgages sourced from third parties. Alternative Single Family also grew but at a slower pace, as increased attrition offset a still healthy level of originations. We believe the increase in attrition resulted from a widening of risk appetite among some larger banks as they have adjusted to the revised B-20 regulations. They appear to have been renewing our Alternative borrowers into Prime products at lower rates, which has altered our competitive dynamics. Originations were down slightly from Q3 partly due to the seasonality of the residential mortgage market.

The increase in our Commercial portfolio was the result of growth in both Conventional commercial and Insured multi-unit residential mortgages. The increase was due to higher originations in both businesses, and despite an increase in attrition levels in our Conventional commercial business.

Table 23: Unaudited interim consolidated statements of income

| (\$ THOUSANDS, EXCEPT PER SHARE AMOUNTS) | Three months ended | | |
|---|--------------------|------------------|------------------|
| | Dec 31, 2019 | Sep 30, 2019 | Dec 31, 2018 |
| Interest income: | | | |
| Loans – Retail | \$ 182,524 | \$ 176,082 | \$ 151,238 |
| Loans – Commercial | 101,546 | 98,477 | 82,059 |
| Investments | 2,462 | 2,304 | 1,825 |
| Other | 6,937 | 6,720 | 4,914 |
| | 293,469 | 283,583 | 240,036 |
| Interest expense: | | | |
| Deposits | 99,385 | 97,169 | 84,433 |
| Securitization liabilities | 65,950 | 64,858 | 55,898 |
| Bank facilities | 1,061 | 1,706 | 3,557 |
| Other | 2,246 | 1,703 | 1,557 |
| | 168,642 | 165,436 | 145,445 |
| Net interest income | 124,827 | 118,147 | 94,591 |
| Provision for credit losses | 3,917 | 3,463 | 628 |
| Net interest income after provision for credit losses | 120,910 | 114,684 | 93,963 |
| Other income: | | | |
| Fees and other income | 6,201 | 6,110 | 4,462 |
| Net gain (loss) on investments | 99 | (327) | (3,754) |
| Gains (losses) on securitization activities and income from securitization retained interests | 3,053 | 3,919 | (1,176) |
| | 9,353 | 9,702 | (468) |
| Net interest and other income | 130,263 | 124,386 | 93,495 |
| Non-interest expenses: | | | |
| Compensation and benefits | 25,920 | 25,696 | 20,021 |
| Other | 28,557 | 24,793 | 19,212 |
| | 54,477 | 50,489 | 39,233 |
| Income before income taxes | 75,786 | 73,897 | 54,262 |
| Income taxes | | | |
| Current | 27,916 | 14,524 | 10,526 |
| Deferred | (7,984) | 4,431 | 3,620 |
| | 19,932 | 18,955 | 14,146 |
| Net income | \$ 55,854 | \$ 54,942 | \$ 40,116 |
| Dividends on preferred shares | 1,118 | 1,191 | 1,190 |
| Net income available to common shareholders | \$ 54,736 | \$ 53,751 | \$ 38,926 |
| Earnings per share | | | |
| Basic | \$ 3.27 | \$ 3.22 | \$ 2.35 |
| Diluted | \$ 3.21 | \$ 3.18 | \$ 2.33 |

Table 24: Unaudited interim consolidated statements of comprehensive income

| (\$ THOUSANDS) | Three months ended | | |
|--|--------------------|--------------|--------------|
| | Dec 31, 2019 | Sep 30, 2019 | Dec 31, 2018 |
| Net income | \$ 55,854 | \$ 54,942 | \$ 40,116 |
| Other comprehensive income – items that will be reclassified subsequently to income: | | | |
| Debt instruments at Fair Value through Other Comprehensive Income: | | | |
| Net unrealized gains (losses) from change in fair value | 80 | (71) | 67 |
| Reclassification of net gains to income | (153) | - | - |
| Other comprehensive income – items that will not be reclassified subsequently to income: | | | |
| Equity instruments designated at Fair Value through Other Comprehensive Income: | | | |
| Net unrealized gains (losses) from change in fair value | 2,604 | (425) | (15,108) |
| Reclassification of net losses to retained earnings | - | - | 3 |
| | 2,531 | (496) | (15,038) |
| Income tax (expense) recovery | (670) | 128 | 3,990 |
| | 1,861 | (368) | (11,048) |
| Cash flow hedges: | | | |
| Net unrealized gains (losses) from change in fair value | 4,969 | 582 | (5,535) |
| Reclassification of net (gains) losses to income | (1,015) | (1,496) | 844 |
| | 3,954 | (914) | (4,691) |
| Income tax (expense) recovery | (1,046) | 240 | 1,244 |
| | 2,908 | (674) | (3,447) |
| Total other comprehensive income (loss) | 4,769 | (1,042) | (14,495) |
| Total comprehensive income | \$ 60,623 | \$ 53,900 | \$ 25,621 |

Table 25: Unaudited interim consolidated statements of cash flows

| (\$ THOUSANDS) | Three months ended | | |
|---|--------------------|--------------|--------------|
| | Dec 31, 2019 | Sep 30, 2019 | Dec 31, 2018 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | | |
| Net income for the period | \$ 55,854 | \$ 54,942 | \$ 40,116 |
| Adjustments for non-cash items in net income: | | | |
| Financial instruments at fair value through income | 5,237 | 4,715 | 11,668 |
| Amortization of premiums/discounts on investments | 340 | 483 | 1,419 |
| Amortization of capital assets and intangible costs | 4,461 | 4,454 | 2,264 |
| Provision for credit losses | 3,917 | 3,463 | 628 |
| Securitization (gains) losses | (2,667) | (2,861) | 2,436 |
| Stock-based compensation | 397 | 389 | 334 |
| Income taxes | 19,932 | 18,955 | 14,146 |
| Securitization retained interests | 8,767 | 7,930 | 7,726 |
| Changes in operating assets and liabilities: | | | |
| Restricted cash | (54,356) | 53,802 | 32,186 |
| Securities purchased under reverse repurchase agreements | 100,011 | (125,011) | (250,000) |
| Loans receivable, net of securitizations | (667,064) | (1,107,255) | (1,881,516) |
| Other assets | 3,097 | (6,234) | (48,956) |
| Deposits | 336,105 | 393,648 | 634,861 |
| Securitization liabilities | 413,303 | 270,452 | 1,059,515 |
| Obligations under repurchase agreements | 43,973 | 463,071 | 42,981 |
| Bank facilities | - | - | 116,457 |
| Other liabilities | 1,972 | (4,769) | 14,768 |
| Income taxes paid | (11,491) | (11,328) | (11,480) |
| Cash flows from (used in) operating activities | 261,788 | 18,846 | (210,447) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | |
| Proceeds from issuance of common shares | 2,161 | 4,132 | 26 |
| Dividends paid on preferred shares | (1,118) | (1,191) | (1,190) |
| Dividends paid on common shares | (5,871) | (5,523) | (4,464) |
| Cash flows used in financing activities | (4,828) | (2,582) | (5,628) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | |
| Purchase of investments | (188,473) | (37,325) | (55,291) |
| Proceeds on sale or redemption of investments | 87,928 | 43 | 193 |
| Net change in Canada Housing Trust re-investment accounts | (15,640) | (24,363) | (83) |
| Purchase of capital assets and system development costs | (5,826) | (5,137) | (7,453) |
| Cash flows used in investing activities | (122,011) | (66,782) | (62,634) |
| Net increase (decrease) in cash and cash equivalents | 134,949 | (50,518) | (278,709) |
| Cash and cash equivalents, beginning of period | 373,904 | 424,422 | 755,952 |
| Cash and cash equivalents, end of period | \$ 508,853 | \$ 373,904 | \$ 477,243 |
| Cash flows from operating activities include: | | | |
| Interest received | \$ 282,038 | \$ 276,761 | \$ 240,814 |
| Interest paid | (157,638) | (173,966) | (171,740) |
| Dividends received | 1,569 | 1,505 | 1,736 |

ACCOUNTING POLICY CHANGES

The Company's significant accounting policies are essential to an understanding of its reported results of operations and financial position. Accounting policies applied by the Company in the 2019 annual consolidated financial statements are the same as those applied by the Company as at and for the year ended December 31, 2018 except for IFRS 16 and IFRS 3 Business Combinations ("IFRS 3"), effective January 1, 2019. Please refer to Notes 3 and 5 to the audited consolidated financial statements for a summary of the Company's other significant accounting policies and computation of the subsidiary's fair value of assets and liabilities at the date of acquisition.

FUTURE ACCOUNTING POLICIES

The revised Conceptual Framework for Financial Reporting ("Framework") and the published "Interest Rate Benchmark Reform: Amendments to IFRS 9, IAS 39 and IFRS 7" ("amendment") are mandatorily effective for annual periods beginning on or after January 1, 2020. The Company has completed its evaluation of the estimated impact of these changes on its accounting policy and consolidated financial statements. Please refer to Note 3 to the audited consolidated financial statements for further discussion.

CRITICAL ACCOUNTING ESTIMATES

The preparation of the consolidated financial statements 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 dates of the consolidated financial statements and the reported amounts of revenue and expenses during the years. Estimates and underlying assumptions are reviewed by management on an ongoing basis. The critical estimates and judgments utilized in preparing the Company's consolidated financial statements affect the assessment of the allowance for credit losses on loans, impairment of other financial instruments, fair values of financial assets and liabilities, derecognition of financial assets transferred in securitization transactions, effectiveness of financial hedges for accounting purposes and income taxes.

In making estimates and judgments, management uses external information and observable market conditions where possible, supplemented by internal analysis as required. These estimates and judgments have been applied in a manner consistent with prior periods and there are no known trends, commitments or events that we believe will materially affect the methodology or assumptions utilized in making these estimates and judgments in these consolidated financial statements. Actual results could differ from these estimates, in which case the impact would be recognized in the consolidated financial statements in future periods.

Allowance for credit losses 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 since initial recognition and in estimating the amount of expected credit losses. The calculation of expected credit losses includes the incorporation of forward-looking forecasts of future economic conditions, 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 modelling process. Changes in these inputs, assumptions, models, and judgements directly impact the measurement of ECLs.

For further information regarding critical accounting estimates, please refer to Note 2(d) to the audited consolidated financial statements.

DERIVATIVE FINANCIAL INSTRUMENTS

The Company hedges interest rate risks associated with insured residential mortgages and mortgage commitments intended for securitization, certain mortgages, securitization and deposit liabilities. The Company also hedges the risk of changes in future cash flows related to our Restricted Share Unit ("RSU") and Deferred Share Unit ("DSU") plans.

The Company's securitization activities are subject to interest rate risk, which represents the potential for changes in interest rates between the time the Company commits to funding a mortgage it intends to securitize through the issuance of a securitization liability, and the time the liability is actually issued. The Company enters into bond forwards to hedge this exposure, with the intent to manage the change in cash flows of the future interest payments on the highly probable forecasted issuance of the securitization liability. The Company applies hedge accounting to these derivative financial instruments to minimize the volatility in income caused by changes in interest rates.

For non-prepayable insured residential mortgages, where the transferred assets qualify for derecognition, the Company uses bond forwards to protect itself from fluctuations in interest rates between the time the Company commits to funding these mortgages and the time they are securitized. The change in value of the commitments and the funded mortgages before securitization are substantially offset by the change in value of the bond forwards and the Company does not apply hedge accounting to these derivative instruments.

The Company uses interest rate swaps to hedge our interest rate exposure on certain loans assets, securitization liabilities and deposit liabilities. The Company applies hedge accounting to these relationships.

The Company also hedges the risk of changes in future cash flows related to our RSU and DSU plans by entering into total return equity swap contracts with third parties, the value of which is linked to the price of the Company's common shares. Changes in the fair value of these derivative financial instruments offset the compensation expense related to the change in share price, over the period in which the swap is in effect. The Company applies hedge accounting to the RSU-related derivative financial instruments but does not use hedge accounting for the DSU-related swaps.

As part of its CMB activities, the Company may assume reinvestment risk between the amortizing MBS and the bullet CMB for securitized mortgages which are derecognized. The Company assumes this risk by entering into total return swaps with highly rated counterparties and exchanging the cash flows of the CMB for those of the MBS transferred to CHT.

For more information on derivative financial instruments see Notes 3, 6, 7, 11, 12, 13, 14 and 17 to the audited consolidated financial statements.

OFF-BALANCE SHEET ACTIVITIES

The Company engages in certain financial transactions that, for accounting purposes, are not recorded on our audited consolidated balance sheets. Off-Balance sheet transactions are generally undertaken for risk, capital and funding management purposes. These include certain securitization transactions, the commitments we make to fund our pipeline of mortgage originations and letters of credit issued in the normal course of business (see Note 23(b) to the audited consolidated financial statements).

SECURITIZATION OF FINANCIAL ASSETS

Certain securitization transactions qualify for derecognition when the Company has transferred substantially all of the risks and rewards or control associated with the securitized assets. The outstanding securitized loan principal that qualified for derecognition totalled \$4.6 billion at December 31, 2019 (December 31, 2018 – \$4.4 billion). The securitization liabilities associated with these transferred assets are approximately \$4.6 billion (December 31, 2018 – \$4.4 billion). The securitization retained interest recorded with respect to certain securitization transactions was \$139.0 million (December 31, 2018 – \$115.3 million) and the associated servicing liability was \$27.8 million at December 31, 2019 (December 31, 2018 – \$26.8 million).

COMMITMENTS AND LETTERS OF CREDIT

The Company provides commitments to extend credit to our borrowers. The Company had outstanding commitments to fund \$1.9 billion of loans and investments in the ordinary course of business at December 31, 2019 (December 31, 2018 – \$1.5 billion).

The Company issues letters of credit which represent assurances that the Company will make payments in the event that a borrower cannot meet their obligations to a third party. Letters of credit in the amount of \$29.1 million were outstanding at December 31, 2019 (December 31, 2018 – \$15.5 million), none of which have been drawn upon.

RELATED PARTY TRANSACTIONS

Certain of the Company's key management personnel have transacted with the Company and/or invested in deposits, and/or the Series 3 preferred shares of the Company in the ordinary course of business, on market terms and conditions. See Note 24 to the audited consolidated financial statements for further details.

RISK MANAGEMENT

Through our wholly owned subsidiary, Equitable Bank, the Company is exposed to risks that are similar to those of other financial institutions, including the symptoms and effects of both domestic and global economic conditions and other factors that could adversely affect our business, financial condition, and operating results. These factors may also influence an investor's decision to buy, sell or hold shares in the Company. Many of these risk factors are beyond the Company's direct control. The Board plays an active role in monitoring the Company's key risks and in determining the policies, practices, controls, and other mechanisms that are best suited to manage these risks.

The Company's business activities, including our use of financial instruments, exposes the Company to various risks, the most significant of which are credit risk, liquidity and funding risk, and market risk.

The Risk Management framework, Credit Risk, Liquidity and Funding Risk Management, and Market Risk Management sections below form an integral part of the 2019 annual consolidated financial statements as they present required IFRS disclosures as set out in IFRS 7 Financial Instruments: Disclosures, which permits cross-referencing between the notes to the financial statements and the MD&A. See Note 4 of the annual consolidated financial statements.

RISK MANAGEMENT FRAMEWORK

The Board has overall responsibility for the establishment and oversight of the Company's Enterprise Risk Management ("ERM") framework. The Company's ERM framework is designed to ensure that all risks are managed within the Company's pre-defined risk appetite thresholds outlined in our Risk Appetite Framework ("RAF"). The Company's ERM and RAF are designed to align our overall corporate strategy, financial and capital plans, business unit strategies and day-to-day operations, as well as our risk management policies and practices (i.e., risk limits, risk selection/underwriting guidelines and criteria, etc.) across the organization. The ERM and RAF are updated by senior management and approved by the Board on an annual basis, or more frequently, if required.

The ERM framework covers the type and amount of risk that the Company is capable and willing to take on in support of its business operations and strategy. The ERM framework is designed to ensure active monitoring of all key current and emerging risks on a continuous basis, and to provide the Board with timely periodic updates on our risk management practices and related economic capital requirements. It also sets out our approach for identifying, assessing, managing and reporting on our key risks, including the establishment of roles, responsibilities, processes, and tools to be used. To ensure that all significant and emerging risks are considered, we review our risk profile with respect to each of our core risks on a continuous basis, and report to the Board at least quarterly. The Company's ERM framework is also designed to ensure that all key risks are managed within our pre-defined risk appetite thresholds as outlined in our RAF, and that the potential for loss remains within acceptable Board-approved limits.

The Company's ERM framework is illustrated below:

Enterprise Risk Management Framework



The Risk and Capital Committee (‘RCC’): The RCC of the Board assists the Board in fulfilling its oversight and governance responsibilities for the management of the Company’s core and emerging risks and the adequacy of our Internal Capital Adequacy Assessment Process (‘ICAAP’), as well as our strategic and capital plans. The RCC specifically assists the Board in fulfilling its oversight role for credit, liquidity and funding, and market risks and receives ongoing periodic reports from the Company’s ERM Committee and Asset and Liability Committee (‘ALCO’) in this regard. The RCC also has primary oversight responsibility for operational risk, business and strategic risk, and reputational risk. In addition, the mandate of the RCC requires that the Committee review and approve the significant risk management policies and frameworks developed and implemented to identify, measure, mitigate, monitor, and report on the Company’s core risks, along with its risk-based capital requirements and the results of its stress testing for all key risks. At present, the RCC is comprised of five independent directors, including the Chairs of the Audit Committee and Human Resources and Compensation Committee. It meets quarterly with the Chief Executive Officer (‘CEO’), Chief Financial Officer (‘CFO’), and the Chief Risk Officer (‘CRO’).

To ensure capital allocation and risk management are aligned, the Company’s ICAAP, which is reviewed annually with the RCC, determines the ongoing capital needs of the business and reviews those needs in the context of our operating environment and strategic plans. Material risks are regularly stress tested to determine their impact on capital and to establish our internal capital adequacy targets on a go-forward basis.

The RCC is supported by the following board and management level committees:

Credit Risk Sub-Committee: The credit risk sub-committee of the RCC is responsible for approving lending transactions which exceed the credit limits that have been delegated to management by the Board.

ERM Committee: The ERM Committee is chaired by the CRO and consists of members of senior management, reports to the RCC, and assists the RCC in fulfilling its oversight and governance responsibilities vis-à-vis the Company’s risk management practices and ICAAP. To ensure that all significant risks that the Company faces are actively managed and monitored, the ERM Committee reviews and monitors the Company’s key and emerging risks, risk trends, the results of our enterprise-wide stress and scenario tests, relevant policies and related risk management considerations/actions to be taken. It reports to the RCC at least quarterly.

Asset and Liability Committee: The RCC oversees the Company's ALCO, which identifies the liquidity as well as the market risks faced by the Company, sets appropriate risk limits and controls, and monitors those risks and adherence to Board approved limits. The ALCO is chaired by the CEO and is comprised of members of senior management.

Other Board Committees that monitor the organizations activities and overall risk profile are as follows:

Audit Committee: The Audit Committee of the Board assists the Board in fulfilling its oversight responsibilities with respect to the quality and integrity of the Company's financial reporting processes and the performance of the internal audit function. The Audit Committee is assisted in fulfilling its mandate by the Company's Finance and Internal Audit departments. Internal Audit undertakes regular and independent reviews of the Company's risk management controls and procedures, the results of which are reported to the Audit and other applicable Board Committees.

Governance and Nominating Committee: The Governance and Nominating Committee of the Board maintains primary oversight over the Company's Legal and Regulatory risk; this includes oversight of the Company's Compliance function and ensures the Company's compliance with all legal and regulatory requirements. The Committee also is responsible for overall corporate governance which includes Board membership, Board effectiveness, development of corporate governance guidelines including a code of conduct, and matters related to the Financial Consumer Agency of Canada.

Human Resources and Compensation Committee: The Human Resources and Compensation Committee of the Board assists the Board in ensuring that the Company's compensation policies and practices are aligned with our risk appetite and risk management frameworks. This ensures that the incentive for management to assume risks in the pursuit of business objectives is aligned with our Board-approved risk appetite.

Under the Company's risk management framework, senior management reports on all key risk issues to at least one of the aforementioned committees of the Board on a quarterly basis.

The Company approach to enterprise-wide risk management aligns with the three lines of defense model:

- i. Business Unit Leaders are the 'first line', and are primarily accountable for identifying, assessing, managing and reporting risk within their functional areas of responsibility.
- ii. The Risk Oversight functions, which include the Finance, Risk and Compliance departments, are accountable for independent oversight of the Business Unit operations from a 'second line' perspective. Given the size and relatively low complexity of the Bank's operations and risk profile, business line management leverages the skills of the 'second line' as subject matter experts to assist in the design of our risk monitoring practices. Due to the inherent expertise embedded in our 'second line', the performance of some traditional 'first line' oversight functions may be undertaken by the 'second line'.
- iii. Internal Audit is accountable for independent assurance as the 'third line of defense'.

CREDIT RISK

Credit risk is defined as the possibility that the Company will not receive the full value of amounts and recovery costs owed to it if counterparties fail to honour their obligations to the Company. Credit risk arises principally from the Company's lending activities, and our investment in debt and equity securities. The Company's exposure to credit risk is monitored by senior management and the ERM Committee, as well as the Risk and Capital Committee of the Board, which also undertakes the approval and monitoring of the Company's investment and lending policies.

The Company's primary lending business is providing first mortgages on real estate located across Canada. All mortgages are individually evaluated by the Company's or our agent's underwriters using internal and external credit risk assessment tools, and are assigned risk ratings in accordance with the level of credit risk attributed to each loan. Each transaction is approved independently in accordance with the authorization structure set out in the Company's policies. Our underwriting approach, particularly in our Core Lending business, places a strong emphasis on security evaluation and judgmental analysis of the risks in the transaction. As a result, for borrowers who have good equity and debt service ratios, we can underwrite mortgages on terms favourable to the Company in situations where other lenders may not be able to reach a satisfactory business

transaction. Since 2014, the Company has been originating insured Single Family prime mortgages through third party agents, in addition to originating them internally. As part of our risk management practices, we ensure that these third party sourced prime mortgages are underwritten to the high standards required of both Company-originated mortgages, as well as those required by our mortgage insurers. We also conduct periodic reviews of our mortgage underwriting and servicing policies, procedures, and practices vis-à-vis the applicable requirements outlined by our mortgage insurers to ensure that we remain compliant with their ongoing operational requirements.

We have implemented a number of Risk Appetite measures which allow the Bank to monitor and control inherent risks at the enterprise and portfolio levels. These measures vary by business unit as may be appropriate, and include a combination of measures such as geographic concentrations, loan classifications, asset concentration limits, and industrial segmentation limits. These limits are monitored and reported to Senior Management and the Board on a regular basis and are also used to inform our strategic planning process.

We have clearly defined underwriting policies and procedures that we adhere to in our mortgage underwriting process. These include a maximum LTV ratio on all uninsured commercial and residential mortgage loans; certain standards with regard to the asset quality and debt service coverage of commercial properties; standards for the marketability of the properties taken as security, including geographic market restrictions; and requirements surrounding the overall credit quality and integrity of all borrowers. We also actively analyze the profile of our lending businesses and new mortgage originations in tandem with external market conditions, including market values and employment conditions that prevail in those markets where we lend. When we judge that the risk associated with a particular region or product is increasing, we adjust our underwriting criteria to ensure that our underwriting policies continue to be prudent and reflective of current and expected economic conditions, and thereby safeguard the future health of our portfolio. When appropriate, we also respond to the changing marketplace with initiatives designed to increase or decrease our mortgage originations, as required, while continuing to ensure a prudent credit risk profile across our entire portfolio.

Adding new products and diversifying is an important means to reduce risk if executed effectively. The Company follows established change management policies and procedures to ensure the successful implementation of new offerings. The Bank has diversified into adjacent retail businesses such as the offering of reverse mortgages to qualifying homeowners. These reverse mortgages enable homeowners to convert a portion of their home equity into cash on a tax-free basis while remaining in their principal residence. Also, starting in Q1 2019, the Bank commenced offering lines of credit to individuals aged over fifty, secured against the CSV of the borrower's participating whole life insurance policy.

Through its Commercial Lending platform, Equitable continues diversifying into 'Specialized Finance' – with a focus on 'Lend to Lender' arrangements. On January 1, 2019, the Bank acquired Bennington, a privately owned company serving the brokered equipment leasing market in Canada with a focus on transportation, construction, and food service equipment. Equitable's strategy with respect to Bennington is to enhance its competitive position in the equipment financing market using Equitable's challenger bank platform and access to cost-effective funding sources.

The Company categorizes individual credit exposures in our lending portfolios using an internal risk rating system that rates each exposure in the portfolio on the basis of perceived risk, or probability of, a potential financial loss – in order to focus management on monitoring higher risk exposures. Each exposure's risk rating is initially determined during the underwriting process and subsequently either confirmed or revised thereafter, as a result of certain trigger events, using customized risk grids applicable to the property type supporting the exposure. In the case of impairment, probable recovery is determined using a combination of updated property-specific information, historical loss experience and management judgment to determine the impairment provision that may be required.

The Company invests in corporate bonds to diversify its liquidity holdings and to generate higher returns. However, such investments expose the Company to credit risk, should the issuer of these securities be unable to make timely interest payments or, under a worst case scenario, if the issuer becomes insolvent. To limit its exposure to credit risk, the Company establishes policies with exposure limits based on credit rating and investment type. Securities rated BBB- and higher (which is considered "low risk") comprised 100% of the Company's corporate bond portfolio at December 31, 2019 (December 31, 2018 – 100%).

The Company also invests in preferred shares to generate returns that meet certain internally acceptable ROE thresholds. These securities also represent a potential source of liquidity for the Company. However, such investments expose the Company to credit risk – should the issuer of these securities be unable to make timely dividend payments or, under a worst case scenario, if the issuer becomes insolvent. To limit its exposure to credit risk, the Company establishes policies with exposure limits based on credit rating and investment type. Securities rated P-2 or higher comprised 41.5% of the Company’s total equity securities portfolio at December 31, 2019, compared to 42.8% a year earlier. Securities rated P-3 or higher comprised 98.2% of the total equity securities portfolio at the end of December 2019 (December 31, 2018 – 99.2%).

The Company’s rating scale for the credit quality of our counterparties is based on both internal and external credit grading systems. Table 26 below maps these grading systems against the categories on the Company’s credit risk exposure ratings scale. It presents the long-term Standard & Poor’s equivalent grades for the Company’s cash and cash equivalents, debt and equity securities, and derivative counterparties. Low risk denotes that there is a very low risk of either default or loss, standard risk that there is a low risk of default or loss, and high risk that there is some concern that default or loss could occur.

Cash and cash equivalents and derivatives ratings are based on the issuer grade of the respective financial institution, their subsidiaries or other financial intermediaries. Debt securities, including corporate bonds, are categorized based on short-term or long-term issue grades, depending on the maturity dates of the securities. Preferred share securities are categorized based on the DBRS preferred share rating scale used in the Canadian securities market. Lending exposures are categorized according to the Company’s internal risk rating framework, which is based on the likelihood of default.

Equitable assigns economic and regulatory capital for our counterparty credit exposures in accordance with OSFI’s CAR Guideline, which is based on standards issued by the BCBS. All deemed credit exposures, such as counterparty credit risk that may arise through deposits placed with banks, derivatives contracts and other activities, are regularly assessed to ensure that such activities are consistent with the Bank’s Board-approved RAF and do not expose the Bank to undue risk of loss. All related counterparty credit limits are approved by senior management and monitored on an ongoing basis to ensure that all such exposures are maintained within approved limits.

Table 26: Credit risk exposure ratings scale

| | Low risk | Standard risk | High risk |
|--|------------|---------------|-----------|
| Cash and cash equivalents, investments, and derivatives: S&P equivalent grade | AAA – BBB- | BB+ – B | B – CC |
| Mortgages receivable: Mortgage risk rating | 0 – 3 | 4 – 5 | 6 – 8 |

Management has assessed the credit quality of the Company’s assets as at December 31, 2019 and 2018, on the basis of the above mapping of internal and external risk ratings to the credit risk exposure categories. The table below provides the gross carrying amount of all financial assets classified as debt instruments in accordance with IFRS 9, for which a loss allowance is calculated, including contractual amounts of undrawn loan commitments, based on the Company’s credit risk exposure rating scale.

Table 27: Credit quality analysis

| (\$ THOUSANDS) | Dec 31, 2019 | | | |
|-------------------|---------------|--------------|------------|---------------|
| | Stage1 | Stage2 | Stage3 | Total |
| Loans receivable: | | | | |
| Low risk | \$ 12,248,376 | \$ 521,467 | \$ - | \$ 12,769,843 |
| Standard risk | 11,235,604 | 2,175,479 | - | 13,411,083 |
| High risk | 209,680 | 131,677 | - | 341,357 |
| Impaired | - | - | 122,454 | 122,454 |
| Total | \$ 23,693,660 | \$ 2,828,623 | \$ 122,454 | \$ 26,644,737 |
| Less allowance | (19,946) | (11,768) | (5,062) | (36,776) |
| | \$ 23,673,714 | \$ 2,816,855 | \$ 117,392 | \$ 26,607,961 |

| (\$ THOUSANDS) | Dec 31, 2019 | | | |
|-------------------|--------------|------------|--------|--------------|
| | Stage1 | Stage2 | Stage3 | Total |
| Loan commitments: | | | | |
| Low risk | \$ 232,030 | \$ 370 | \$ - | \$ 232,400 |
| Standard risk | 927,607 | 169,807 | - | 1,097,414 |
| High risk | 6,177 | 147 | - | 6,324 |
| Total | \$ 1,165,814 | \$ 170,324 | \$ - | \$ 1,336,138 |
| Less allowance | (107) | (24) | - | (131) |
| | \$ 1,165,707 | \$ 170,300 | \$ - | \$ 1,336,007 |

| (\$ THOUSANDS) | Dec 31, 2018 | | | |
|-------------------|---------------|--------------|-----------|---------------|
| | Stage1 | Stage2 | Stage3 | Total |
| Loans receivable: | | | | |
| Low risk | \$ 10,755,321 | \$ 686,403 | \$ - | \$ 11,441,724 |
| Standard risk | 8,337,306 | 3,415,099 | - | 11,752,405 |
| High risk | 122,818 | 195,824 | - | 318,642 |
| Impaired | - | - | 38,931 | 38,931 |
| Total | \$ 19,215,445 | \$ 4,297,326 | \$ 38,931 | \$ 23,551,702 |
| Less allowance | (14,491) | (9,141) | (1,526) | (25,158) |
| | \$ 19,200,954 | \$ 4,288,185 | \$ 37,405 | \$ 23,526,544 |

| (\$ THOUSANDS) | Dec 31, 2018 | | | |
|-------------------|--------------|------------|--------|--------------|
| | Stage1 | Stage2 | Stage3 | Total |
| Loan commitments: | | | | |
| Low risk | \$ 114,825 | \$ - | \$ - | \$ 114,825 |
| Standard risk | 638,894 | 249,144 | - | 888,038 |
| High risk | - | - | - | - |
| Total | \$ 753,719 | \$ 249,144 | \$ - | \$ 1,002,863 |
| Less allowance | (105) | (35) | - | (140) |
| | \$ 753,614 | \$ 249,109 | \$ - | \$ 1,002,723 |

The following table sets out the credit analysis for financial assets measured at FVTPL and for equity securities measured at FVOCI.

Table 28: Credit analysis for financial assets

| (\$ THOUSANDS) | Dec 31, 2019 | Dec 31, 2018 |
|----------------------------------|--------------|--------------|
| Debt Instruments: | | |
| Loan receivables – FVTPL | | |
| Low risk | \$ 96,779 | \$ 122,456 |
| Standard risk | 98,272 | 121,398 |
| Carrying amount | \$ 195,051 | \$ 243,854 |
| Investments – FVTPL | | |
| Low risk | \$ 41,059 | \$ 18,200 |
| Standard risk | 7,281 | 7,705 |
| High risk | 6,093 | 4,626 |
| Carrying amount | \$ 54,433 | \$ 30,531 |
| Equity Instruments: | | |
| Equity Securities – FVTPL | | |
| High risk | \$ 1,100 | \$ 292 |
| Carrying amount | \$ 1,100 | \$ 292 |
| Equity Securities – FVOCI | | |
| Low risk | \$ 31,614 | \$ 36,263 |
| Standard risk | 55,766 | 58,068 |
| High risk | 5,007 | 6,276 |
| Carrying amount | \$ 92,387 | \$ 100,607 |

Cash and cash equivalents

The Company held cash and cash equivalents of \$508.9 million as at December 31, 2019. The cash and cash equivalents are held with financial institutions that are rated at least A- to AAA, based on S&P ratings.

Collateral held as security

All mortgages are secured by real estate property located in Canada. Appraised values for collateral held against mortgages are obtained at the time of origination and are generally not updated, except when a mortgage is individually assessed as impaired. For impaired mortgages, the most recent appraised value of collateral at December 31, 2019 was \$149 million (December 31, 2018 – \$49 million). At December 31, 2019, the appraised values of collateral held for mortgages considered past due but not impaired, as determined when the mortgages were originated, was \$88 million (December 31, 2018 – \$77 million). It is the Company's policy to pursue the timely realization of collateral in an orderly manner.

Real estate from foreclosures that were owned and held for sale at December 31, 2019 amounted to \$1.6 million (December 31, 2018 – \$1.4 million) and are included in Other assets (Note 14) in the consolidated balance sheets. The Company does not use the real estate obtained through foreclosure for its own operations.

Leases are secured by first charges against the equipment leased, and may include guarantees and other additional charges against other assets such as real estate. Values for the equipment securing leases is typically determined at the origination of the lease and generally not updated, except when a lease is individually assessed as impaired. For impaired leases, the value of expected realizations from charges and against equipment and other security at December 31, 2019 was \$5.3 million (December 31, 2018 – \$nil).

The Company does not hold collateral against investments in debt and equity securities; however, securities received under reverse repurchase agreements are allowed to be sold or re-pledged in the absence of default by the owner. The Company

has a commitment to return collateral to the counterparty in accordance with the terms and conditions stipulated by the master repurchase agreement. Equitable has no contractual agreement with any counterparty that required it to post increased collateral in the event of a credit rating downgrade of Equitable Bank.

The contractual amount outstanding on financial assets that were written off during the year amounted to \$3.1 million (December 31, 2018 - \$2.8 million). These amounts are still subject to enforcement activity.

Credit concentration risk

A key component of credit risk that is closely monitored and measured within the exposures in our unsecuritized portfolio, is credit concentration risk. By way of definition, credit concentration risk results if an unduly large proportion of the Company's lending business involves a single person, organization or group of related persons or organizations, a single geographic area, a single industry or a single category of investment. The ability of these counterparties to meet contractual obligations may be similarly affected by changing economic or other conditions. On a regular basis, with the approval of the Board, management establishes credit limits for exposure to certain counterparties, industries or market segments, monitors these credit exposures, and prepares detailed analyses and reports assessing overall credit risk within the Company's lending exposures and investment portfolios.

Management believes that it is adequately diversified by borrower, property type and geography. At December 31, 2019, no individual borrower represented more than \$100 million (December 31, 2018 – \$138 million) or 0.7% (December 31, 2018 – 1.04%) of uninsured loan principal outstanding. See Tables 7 and 13 of our Q4 2019 unaudited Supplemental Information and Regulatory Disclosures Report for a breakdown of loan principal outstanding by property type and geography, respectively.

LIQUIDITY AND FUNDING RISK

We define Liquidity and Funding risk as the possibility that the Company will be unable to generate sufficient funds in a timely manner and at a reasonable price to meet our financial obligations as they come due. These financial obligations mainly arise from the maturity of deposits, maturity of mortgage-backed securities, and commitments to extend credit. Funding and Liquidity Risk may also be affected if an unduly large proportion of the Company's deposit-taking business involves a single person, organization or group of related persons/organizations or a single geographic area.

In accordance with our RAF, the Board defines the Company's liquidity and funding risk tolerance as 'low', and also reviews and approves the limits to measure and control this risk. These limits are articulated via our Board-approved Liquidity and Funding Risk Management Policy – which is updated annually, at a minimum. This Policy requires us to maintain a pool of high quality liquid assets and stipulates various liquidity ratios and limits, concentration limits and, among other considerations, ongoing periodic liquidity stress testing requirements. We also adhere to the OSFI's Liquidity Adequacy Requirement ("LAR") Guideline, which provides the framework within which OSFI assesses whether a federally-regulated financial institution maintains adequate liquidity. Our liquidity position and adherence to the requirements are monitored on a daily basis by senior management. Key metrics are also reported monthly to the ALCO and, quarterly, both to the ERM Committee and the RCC of the Board. Any exceptions to established Policy or regulatory limits are reported immediately to the ALCO or to the Board, as applicable. As at December 31, 2019, we were in compliance with all related regulatory requirements.

Our practice is to hold a sufficient amount of liquidity on our balance sheet to ensure that we remain well positioned to manage unexpected events that may reduce/limit our access to funding. We closely monitor our liquidity position on a daily basis and ensure that the level of liquid resources held, together with our ability to raise new deposits, is sufficient to meet our funding commitments, deposit maturity obligations, and properly discharge our other financial obligations. Actual liquidity may vary from period to period, mainly due to the timing of anticipated cash flows and funding seasonality. In addition to our funding and liquidity management policies and procedures, we have also developed a Liquidity and Funding Risk Contingency Plan and an OSFI-mandated Comprehensive Recovery Plan, which outlines actions to be undertaken to address the outflow of funds in the event of a funding or liquidity crisis.

Table 29: Assets held for liquidity protection

| (\$THOUSANDS EXCEPT PERCENTAGES) | Policy minimum | 2019 | 2018 |
|---|----------------|--------------|--------------|
| Liquidity assets held for regulatory purposes | | \$ 1,575,297 | \$ 1,263,835 |
| Liquidity assets as a % of minimum required policy liquidity ⁽¹⁾ | 100% | 178% | 203% |

⁽¹⁾ For purposes of this calculation, Equitable's Liquidity and Funding Risk Management Policy requires the value of assets held for liquidity protection to be reduced to reflect their estimated liquidity value.

Stress and scenario testing is an integral part of Equitable's Liquidity and Funding Risk Management framework and supports the development of action plans to address funding needs in stressed environments. We manage our funding needs to ensure that we can meet our financial commitments in a timely manner and at reasonable prices, even in times of stress. The Company's stress-testing models consider scenarios that incorporate institution-specific, market-specific and combination events. These scenarios model cash flows over a one-year period incorporating such factors as a decline in capacity to raise new deposits, lower liquidity values for market investments and an accelerated redemption of notice deposits. In order to establish these scenarios, we assess our fund-raising capacity and establish assumptions related to the cash flow behavior of each type of asset and liability. In each scenario, the Company targets to hold sufficient liquid assets and have fundraising capacity sufficient to meet all obligations for at least a three-month forecast period while maintaining normal business activities. As at December 31, 2019, we held sufficient liquid assets and maintained sufficient funding capacity to meet all funding obligations over the one-year forecasting period under all considered scenarios.

Since 2013, we have actively diversified our funding sources in order to proactively manage our funding risk profile. This diversification has been accomplished through the launch of our direct-to-consumer platform, *EQ Bank*, the addition of several large bank sponsored funding facilities, a deposit note program, and new securitization vehicles. Also, in 2018, the Bank received approval of the Minister of Finance (Canada) for letters patent to incorporate a trust company under the Trust and Loan Companies Act (Canada) and, on December 19, 2018, received the "Order to Commence and Carry on Business" from OSFI. The new wholly-owned trust subsidiary commenced business in early 2019 and is expected to provide an additional source of funding diversification for the Bank as it is a new issuer of deposits that is eligible for CDIC insurance coverage.

In Q2 2017, we implemented a \$2 billion contingent funding facility with a consortium of Canada's six largest banks. This committed facility was put in place to mitigate potential liquidity risks resulting from market conditions at the time. We have continuously and successfully enhanced our liquidity management efforts by increasing the size of our liquid asset portfolio, extending the average term of our GIC book, improving the functionality and brand profile of our *EQ Bank* platform, and reducing our exposure to more volatile brokered HISAs. As such, in June 2018 we reduced the size of this facility to \$850 million and in June 2019 further reduced it to \$400 million while completing a 2-year renewal.

The following table summarizes contractual maturities of the Company's financial liabilities.

Table 30: Contractual obligations⁽¹⁾

| (\$ THOUSANDS) | Payments due by period | | | | |
|---|------------------------|----------------------|----------------------|----------------------|---------------------|
| | Total | Less than 1 year | 1 – 3 years | 4 – 5 years | After 5 years |
| Deposits principal and interest | \$ 12,602,924 | \$ 6,371,733 | \$ 4,841,360 | \$ 1,389,831 | \$ - |
| Securitization liabilities principal and interest | 28,192,148 | 4,999,249 | 9,929,038 | 8,708,268 | 4,555,593 |
| Bank facilities principal and interest | 383 | 383 | - | - | - |
| Other liabilities | 166,373 | 145,464 | 10,622 | 5,888 | 4,399 |
| Total 2019 contractual obligations | \$ 40,961,828 | \$ 11,516,829 | \$ 14,781,020 | \$ 10,103,987 | \$ 4,559,992 |
| Total 2018 contractual obligations | \$ 32,108,870 | 9,009,133 | 11,936,059 | 7,969,649 | 3,194,029 |

⁽¹⁾ The balances for financial liabilities will not agree with those in our consolidated balance sheet as this table incorporates all on and off balance sheet obligations, on an undiscounted basis, including both principal and interest. Prior year amounts have been adjusted accordingly.

See Note 23 to the consolidated financial statements for credit commitments and contingencies as at December 31, 2019 and 2018.

MARKET RISK

Market Risk consists of Interest Rate risk and Equity Price risk, and is broadly defined as the possibility that changes in either market interest rates or equity prices may have an adverse effect on our profitability or financial condition. Interest rate risk may be affected if an unduly large proportion of our assets or liabilities have unmatched terms, interest rates or other attributes, such as optionality features embedded in our cashable deposits or mortgage commitments. For the interest sensitivity position of the Company as at December 31, 2019, see Note 26 to the consolidated financial statements. With respect to Equity Price risk, the value of our securities portfolio may be impacted by market determined variables which are beyond our control, such as benchmark yields, credit and/or market spreads, implied volatilities, the possibility of credit migration and default, among others. Overall, we have a 'low' appetite for Market risk.

With respect to structural Interest Rate risk, our objective is to manage and control the Company's interest rate risk exposures within acceptable parameters and our primary method of mitigating this risk involves funding our assets with liabilities of a similar duration. The Bank also maintains a hedging program to manage its economic value to its target risk. The responsibility for managing the Company's Interest Rate risk resides with the ALCO, which meets monthly to review and approve all Treasury-related policies, to review key Interest Rate Risk metrics, and to provide direction on our operating and funding strategy. Also, senior management continuously reviews our interest rate risk profile and monitors the Company's ongoing funding strategy through the daily interest rate-setting process.

We monitor Interest Rate Risk by utilizing simulated interest rate change sensitivity models to estimate the effects of various interest rate change scenarios on net interest income and on the economic value of shareholders' equity ("EVE"). EVE is a calculation of the present value of the Company's asset cash flows, less the present value of liability cash flows on an after-tax basis. Management considers this measure to be more comprehensive than measuring changes in net interest income, as it captures all interest rate mismatches across all terms. Certain assumptions that are based on actual experience are also built into the simulations, including assumptions related to the pre-maturity redemption of deposits and early payouts of mortgages.

The table below illustrates the results of management's sensitivity modeling to immediate and sustained interest rate increase and decrease scenarios. The models measure the impact of interest-rate changes on EVE and NII during the 12-month period following December 31, 2019. The estimate of sensitivity to interest rate changes is dependent on a number of assumptions that could result in a different outcome in the event of an actual interest rate change.

Table 31: Net interest income shock

| (\$ THOUSANDS EXCEPT PERCENTAGES) | Increase in interest rates | Decrease in interest rates ⁽¹⁾ |
|--|-------------------------------|--|
| 100 basis point shift | | |
| Impact on net interest income | \$ 15,060 | \$ (2,001) |
| Impact on EVE | (12,142) | 10,800 |
| EVE impact as a % of common shareholders' equity | (0.9%) | 0.8% |
| 200 basis point shift | | |
| Impact on net interest income | \$ 26,950 | \$ (2,327) |
| Impact on EVE | (21,927) | 25,904 |
| EVE impact as a % of common shareholders' equity | (1.6%) | 1.9% |

⁽¹⁾ Interest rate is not allowed to decrease beyond a floor of 0% and is therefore not allowed to be negative.

The management of Equity Price risk is assigned to the ALCO by the RCC of the Board. The ALCO manages the Company's securities portfolio in accordance with its 'Marketable Securities Policy' and takes into consideration the following factors:

- General economic conditions and the possible effect of inflation or deflation;
- The expected tax consequences of investment decisions or business strategies;
- The credit quality of each investment and its role within the overall portfolio;

- The expected total return from income and the appreciation of capital;
- The Bank's need for liquidity, available capacity, and regularity/stability of earnings; and
- Each investment's special relationship or special value, if any, to the overall objectives of the portfolio.

On a monthly basis, the ALCO reviews the investment performance, composition, quality and other pertinent characteristics of the securities portfolio. This information is also presented to, and reviewed by, the RCC of the Board at least quarterly, or more frequently, if required.

OPERATIONAL RISK

We define Operational risk as the possibility that a loss could result from people, inadequate or failed internal processes or systems, or from external events. Our definition specifically excludes legal risk – which we include under the 'Legal and Regulatory Risk' category below.

Operational risk is present in virtually all business activities of the Company and includes such considerations as fraud, damage to equipment, system failures, data entry errors, model risk, cyber security and business continuity. We also consider natural disasters in our assessment of operational risk, to the extent that they may impact collateral values or other pertinent loan loss drivers. As outlined in the Company's RAF, Equitable has a 'low' appetite and a 'low-to-medium' tolerance for Operational Risk. We recognize that while the nature of operational risk is such that there is little or no expected reward in taking on this risk, the costs to attempt to eliminate operational risk may be excessive.

The Company's Operational Risk Management program includes the following key components:

- **Governance:** While Operational risk may not be completely eliminated, proactive management of this risk is very important in order to mitigate exposure to financial losses, reputational damage and/or regulatory fines. We have implemented a Board-approved *Operational Risk Management Policy* and an *Operational Risk Management Framework*, which are jointly designed to monitor, review and report on operational risk management across the Company. Both the Policy and the related Framework articulate our governance practices for the proper management of Operational risk and include clear accountabilities for the three-lines-of-defense (i.e., Business Units, Risk Management and related oversight functions such as Compliance and Finance, and Internal Audit) – in alignment with both the BCBS's '*Principles for the Sound Management of Operational Risk*', and with OSFI's related '*Operational Risk Management Guideline*'. Given the size of the Company, the relatively low complexity of our business operations and our operational risk profile, business line management leverages the skills of the second line as subject matter experts to assist in the development of our operational risk monitoring practices. Additionally, given the expertise embedded in our second line of defense, the performance of some first line operational risk management activities are undertaken by the second line.
- **Training:** All employees within our organization are required to play a role in managing Operational risk. In this regard, we conduct operational risk management and cyber security awareness training and testing for all employees across the Company – to provide them with an overview of the various types of operational risks, and their respective roles and responsibilities in helping to protect the interests and assets of the Company.
- **Risk and Control Self-Assessments ("RCSA's"):** We use these tools on an annual basis to help us identify and evaluate operational risk factors within our individual business and functional units, as well as on a Company-wide basis. These tools assist us in the proactive identification and assessment of key operational risks inherent in our material activities and systems, and in evaluating the effectiveness of controls that are in place to manage these risks.
- **Key Risk Indicators ("KRI's"):** As part of our RCSA monitoring exercise, we utilize KRI's to measure, monitor and report on the level of operational risk on a business/functional unit basis, as well as across the organization. These KRI's also serve as early warning triggers to highlight potential issues before the Company experiences an incident or loss event.
- **Other Operational Risk Management ("ORM") Tools:** In addition to the RCSA's and KRI's noted above, a number of other operational risk management tools are in use as part of the Company's ORM program – these include an operational risk taxonomy, operational risk event collection and analysis, and change management risk and control assessment.

- **Risk Measurement and Reporting:** On a regular monthly basis, our centralized Operational Risk Management Team consolidates key operational risk management trends, significant events, if any, and KRI's across the Company; these are reported to the ERM committee and to the RCC of the Board on a quarterly basis, at a minimum.
- **Business Continuity Management:** The Company maintains a robust Business Continuity Management program, which includes a 'Crisis Management Plan' – to ensure that we have the capability to sustain, manage and recover critical operations and processes in the event of a business disruption, thereby minimizing any adverse effects on our customers, partners and other stakeholders. Our Business Continuity Management Program is comprised of various plans (i.e., Crisis Management Plan, Business Continuity Plans, Disaster Recovery Plan and our Comprehensive Recovery Plan) to ensure the ability to operate as a going concern in the event of a severe business disruption. All key business units within the organization are required to maintain, and regularly test and review, their business continuity plans.
- **Enterprise Change Management:** Effective change management is key to successful implementation and execution of our business strategies and objectives. Equitable Bank is committed to effective management of changes through use of established controls and processes that consider the materiality and risk of each change before it is undertaken. Our change management practices involve assessment of change materiality, appropriate engagement of key stakeholders and support areas. All material changes are subject to a comprehensive assessment of impact to the Bank's core risks to ensure appropriate identification and mitigation of risks. In addition, all material changes are subject to a more detailed assessment of operational risks to ensure appropriate identification and mitigation of risks as part of the project management, implementation plans, post implementation activities, and operational execution.
- **Fraud:** Equitable Bank maintains a robust control framework designed to manage the risks related to misrepresentation and fraudulent activities across the Bank.

Our approach to Fraud Risk management has been to:

- Utilize established Operational Risk Management tools as well as specific fraud related tools and processes to support the identification, assessment, measurement and mitigation of fraud risk;
- Establish the reporting and monitoring processes to support the approach; and
- Establish a culture of risk awareness and understanding throughout all Business Units within the organization so that fraud risk and its associated implications are considered in all significant decisions.

We have processes to keep our fraud controls relevant, agile, and current to accommodate new products, new channels and evolving fraud trends. The existing fraud risk management program utilizes proactive measures to deter, prevent and detect fraud, rather than solely relying upon reactive measures. Our fraud risk management framework is oriented around our three lines of defense model. Our first line business unit processes in mortgage underwriting and deposit taking form the primary layer of defense against external fraudulent activities. Here our businesses focus on early detection and rejection of potentially fraudulent transactions. Remaining vigilant, particularly in the face of regulatory changes, tightening mortgage qualification criteria, and changing housing prices, we have continually enhanced our capabilities through the adoption of new technologies (ex. Equifax's Citadel tool), the maintenance and use of data strategically, and the continual development of training and awareness programs for staff.

Centrally, and operating as a 2nd line centre of excellence in conjunction with our Compliance and AML teams, we operate a Central Fraud team to provide independent oversight of 1st line activities, expert assistance in detection, the development and delivery of training, as well as policy development and Quality Assurance. Our Internal Audit team provides 3rd line oversight of fraud prevention activities. The 2nd and 3rd lines provide independent reporting to committees of the Board on a regular basis.

- **Model Risk:** We define Model risk as the potential for adverse consequences arising from decisions based on incorrect or misused models and their outputs. It can lead to financial loss, reputational risk, or incorrect business and strategic decisions. Model Risk is viewed by the Company as a key component of 'Operational risk'.

In September 2017, OSFI issued the final version of its Guideline E-23: Enterprise-Wide Model Risk Management, which has set this Guideline's implementation timeline for Standardized Institutions such as ourselves at January 2019. We have a 'low' appetite and tolerance for Model risk and have implemented the principles set out in this Guideline. A Model Risk Policy, Model Validation Framework, and Model Validation Procedures are in place to ensure the effective identification and mitigation of Model Risk.

- **Technology and Cyber Security:** With our enhanced use of the internet and mobile technologies as a branchless bank, we maintain an increased focus on the confidentiality, integrity and availability of our information and cyber security controls that protect our network, data and infrastructure. The cyber security risk landscape includes numerous cyber threats such as hacking threats, identity theft, denial of service, and advanced persistent threats. These and other cyber threats continue to become more sophisticated, complex, and potentially damaging. Third party service providers that we use may also be subject to these risks which can increase our risk of potential attack. We continually assess the performance of third-party suppliers against industry standards. In addition, we have limited control over the safety of our clients' personal devices that may be used to conduct transactions. To manage these risks, our defense systems are designed as an integral part of both our existing Equitable Bank infrastructure, and our new architecture and development for our digital banking platform.

We view cyber risk as a key component of Operational Risk and the Company proactively maintains a "defense in depth" strategy with developed standards and procedures to prevent, detect, respond, manage and address cyber security threats from all types of malicious attackers that attempt to steal sensitive information, cause a system failure or denial of service on websites or other types of service disruption.

Our 'Cyber Security Policy' and 'Information and IT Security Policy' establish the requirements and set out the overall framework for managing cyber and information security related risks across the Company. These include developing and implementing the appropriate activities to detect, respond to and contain the impact of cyber security threats, along with implementing the appropriate safeguards to ensure the delivery of critical infrastructure services.

Also, KRI's have been established to measure, monitor, and report this risk to the Board on a regular, periodic basis. Furthermore, we also have an established IT Roadmap with the objective of continuously improving the strength of our practices and capabilities.

We work closely with our critical cyber security and software suppliers to ensure that our technology capabilities remain cyber resilient and effective in the event of any unforeseen cyber-attack. Our internal teams receive daily cyber security updates, rehearse incident table-top exercises, and take specialized training in an effort to thwart current and evolving cyber threats.

Risks are actively managed through information security management programs which include regular vulnerability assessments conducted by qualified 3rd parties on an annual basis, completion of the OSFI Cyber Security Self-Assessment and continuous improvements to the Bank's security and change management practices based on best practices from recognized industry associations.

Equitable Bank has not experienced any material cyber security breaches and has not incurred any material expenses with respect to the remediation of such cyber events.

Security risks continue to be actively monitored and reviewed, leveraging the expertise of the Bank's service providers and vendors, reviewing industry best practices and regularly re-assessing controls in place to mitigate the risks identified.

- **Data Management and Privacy Risk:** The use and management of data and its governance are becoming increasingly important as we continue to invest in digital solutions and innovation, the move of our core banking system to the cloud and the ongoing expansion of business activities. There are regulatory compliance risks associated with data management and privacy as well, which form part of the Bank's Regulatory Compliance Management Program as discussed in the Legal and Regulatory Risk section below. We have established a dedicated Enterprise Data Management

team to ensure we effectively address current and future data needs (quality, security, integrity), and that we are positioned to address emerging requirements from a data management planning and governance perspective.

- **Environmental Risk:** Environmental risk is the possibility of loss of strategic, financial, operational or reputational value resulting from the impact of environmental issues or concerns, including climate change, and related social risk. The Bank may be exposed to environmental risks both through emerging regulatory and legal requirements, disruptions to its operations and services, the products and services that it provides to its customers, as well as through its customers themselves. To manage this risk, we evaluate environmental factors as part of our underwriting process. We consider the environmental risk associated with Single Family residential lending to be low so do not conduct environmental assessments for each of those loans. For the majority of our commercial loan portfolio, we employ third-party consultants to carry out detailed environmental assessments. We also maintain a diversified lending portfolio, which improves our resilience to geographic or sectoral specific environmental developments or events.

We consider this risk to be a component of Operational risk. Management conducts analyses of this risk at periodic intervals to determine its potential impact on the Company's assets in certain geographical regions which are prone to such disasters, including an extensive stress test on earthquake risk. Based on the results of these stress tests, refinements are made to our RAF, where considered appropriate and prudent.

- **Third Party Risk:** Third party suppliers are integral to the Company's business operations and the Company has designed a program to provide oversight for third party relationships. Our approach to third party risk mitigation is outlined in policies and procedures that establish the minimum requirements for identifying and managing risks throughout the engagement life cycle with a third party. Performance monitoring and due diligence reviews are conducted on a regular basis. A higher level of due diligence is focused on our material arrangements to ensure that service levels are met, and that their system of controls is adequate. Outsourcing arrangements are reviewed on a regular (annual) basis to assess materiality, and to ensure regulatory requirements (i.e. OSFI B-10 Outsourcing Guideline) are met. We continue to evolve and improve our capabilities in this area, and with ever increasing reliance on external technology services, we expect that third party risk management will be subject to increased levels of regulation in the coming years.

Operational risk loss events

The Company has a process and procedures in place for monitoring and reporting operational losses as well as near miss events. A near miss is an event that otherwise meets the definition of an operational loss event, but for which no financial loss has been incurred, not because of effective control but because of fortuitous circumstances. Our established processes include completing root cause analysis and action plans for loss and near miss events within defined thresholds. This helps ensure that actions are taken to mitigate future recurrence and potential negative impacts to financial, regulatory compliance, or to the image/ reputation of the bank. During 2019, we did not experience any material operational risk loss events.

LEGAL AND REGULATORY RISK

Legal and Regulatory Risk is defined as the possibility that a loss could result from exposure to fines, penalties, or punitive damages from civil litigations, contractual obligations, criminal or supervisory actions, as well as private settlements; and from not complying with regulatory requirements, regulatory changes or regulators' expectations.

In accordance with our Board-approved RAF, we have a 'very low' appetite and a 'low' tolerance for Legal and Regulatory risk. We undertake reasonable and prudent measures designed to achieve compliance with governing laws and regulations; this includes Equitable's Regulatory Compliance Management ("RCM") Program – which is designed to identify and manage our continuously evolving legal and regulatory requirements. We also undertake reasonable and prudent measures designed to achieve compliance with governing laws and regulations, and promote a strong culture of compliance management across the organization. The Company's business units are engaged in the identification and proactive management of our legal and regulatory risks, while the Compliance, Legal, Anti-Money Laundering and Risk Management teams assist them by providing ongoing guidance and oversight. Management of these risks also includes the timely escalation of issues to senior management and to the Board.

The Company's RCM Program provides us with a control framework to manage and mitigate our exposure to regulatory risk – consistent with all applicable Canadian regulatory expectations, such as those mandated by OSFI, the CDIC, FINTRAC, and Financial Consumer Agency of Canada ("FCAC").

BUSINESS AND STRATEGIC RISK

Business and Strategic risk is defined as the possibility that we could experience material losses or reputational damage as a result of our business plans and/or strategies, the implementation of those strategies, or the failure to properly respond to changes in the external business environment. Business and Strategic risk management includes the following components:

- **Competitive Risk:** Competitive risk is the risk of an inability to build or maintain a sustainable competitive advantage in a given market or markets, and includes potential for loss of the market share due to competitors offering superior products or services. Competitive risks can arise from within or outside the financial sector, from traditional or non-traditional competitors. The banking business is highly competitive and Equitable Bank's products compete with those offered by other banks, trust companies, insurance companies, and other financial services companies in the jurisdictions in which it operates. Many of these companies are strongly capitalized and hold a larger share of the Canadian banking market. There is always a risk that there will be new entrants in the market with more efficient systems and operations that could impact our lending or deposit-taking market share.

We do not use proprietary retail branches to originate deposits or loan exposures. Deposits are raised directly through our online digital platform. Additionally, we rely primarily on business conducted on behalf of investing clients by members of the Investment Industry Regulatory Organization of Canada ("IIROC"), the Registered Deposit Brokers Association ("RDBA") and the Mutual Fund Dealer Association ("MFDA") to distribute our deposit products. Lending exposure originations depend on a network of independent mortgage and lease brokers, brokerage firms and mortgage banking organizations. Under adverse circumstances, it may be difficult to attract enough new deposits from agents or lending business from brokers to meet our current operating requirements. The potential failure to sustain or increase current levels of deposits or lending originations from these sources could negatively affect the financial condition and operating results of the Company.

- **Systemic Risk:** Systemic risk is a risk that the financial system as a whole, or major part of it, may collapse with the likelihood of material damage to the economy, resulting in financial, legal, operational, and reputational risks for the Bank.

The Bank significantly operates in Canada and deposits its monies with other Banks that are AAA or higher rated. An event of systemic crisis may result in higher unemployment and lower family income, corporate earnings, business investment and consumer spending and could adversely affect the demand for our loan products resulting in higher provisions for credit losses.

The Company's Board has approved a 'low-to-medium' appetite and tolerance for Business and Strategic risk. We believe that this risk is best managed via a robust and dynamic annual strategic planning process that includes establishing Board-approved business growth strategies and quantifiable performance targets for each business segment over the forthcoming three-to-five year period. Management of this risk also includes regular monitoring of actual versus forecasted performance and an effective internal monitoring and reporting process – to the ERM Committee and the Board.

REPUTATIONAL RISK

Reputational risk is the possibility that current and potential customers, counterparties, analysts, shareholders, investors, regulators or others will have an adverse opinion of the Company – irrespective of whether these opinions are based on facts or merely public perception. Such an event could result in potential losses to the Company arising from a decline in business volumes, challenges accessing funding markets, or increased funding costs.

In accordance with our Board-approved RAF, our appetite and tolerance for Reputational risk both remain 'low' and the Company believes that the pursuit of our long-term goals requires the proper conduct of our business activities in accordance

with our established Code of Conduct and business principles, as well as with all applicable laws and regulations. Equitable also maintains a Board-approved Reputational Risk Management Policy which, along with related compliance policies and procedures and our ERM practices, is sufficiently designed to identify, assess and manage the reputational and other non-financial considerations present within the Company's business.

UPDATED SHARE INFORMATION

At February 24, 2020, the Company had 16,797,593 common shares and 3,000,000 non-cumulative 5-year rate reset preferred shares issued and outstanding. In addition, there were 577,012 unexercised stock options, which are, or will be, exercisable to purchase common shares for maximum proceeds of \$35.1 million.

DISCLOSURE CONTROLS AND PROCEDURES

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is accumulated and communicated to senior management, including the President and Chief Executive Officer and the Chief Financial Officer, on a timely basis to enable appropriate decisions to be made regarding public disclosure. Management has evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in the rules of the Canadian Securities Administrators) as of December 31, 2019. Based on that evaluation, management has concluded that these disclosure controls and procedures were effective.

INTERNAL CONTROL OVER FINANCIAL REPORTING

Our Internal Control over Financial Reporting framework is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with IFRS. Management has evaluated the design and operational effectiveness of the Company's Internal Controls over Financial Reporting as of December 31, 2019 to provide reasonable assurance regarding the reliability of financial reporting. This evaluation was conducted in accordance with the Integrated (2013) Framework published by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"), a recognized control model, and the requirements of National Instrument 52-109 of the Canadian Securities Administrators. Based on this evaluation, management has concluded that the Company's Internal Controls over Financial Reporting were effective as of December 31, 2019.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There were no changes in the Company's internal control over financial reporting that occurred during 2019 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

NON-GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (“GAAP”) FINANCIAL MEASURES

Management uses a variety of financial measures to evaluate the Company’s performance. In addition to GAAP prescribed measures, management uses certain non-GAAP measures that it believes provide useful information to investors regarding the Company’s financial condition and results of operations. Readers are cautioned that non-GAAP measures often do not have any standardized meaning, and therefore, are unlikely to be comparable to similar measures presented by other companies. The primary non-GAAP measures used in this MD&A are:

- **Adjusted results:** in periods where management determines that non-recurring or unusual items will have a significant impact on a user’s assessment of business performance, the Company may present adjusted results in addition to reported results by removing the non-recurring or unusual items from the reported results. Management believes that adjusted results, if any, can to some extent enhance comparability between reporting periods or provide the reader with a better understanding of how management views the Company’s performance. Adjusted results are also intended to provide the user with greater consistency and comparability to other financial institutions. Adjustments that remove non-recurring or unusual items from net income will affect the calculation of other measures such as adjusted ROE and adjusted EPS.

Reconciliation of Adjusted net income, Adjusted net income available to common shareholders and Adjusted ROE

| (\$ THOUSANDS, EXCEPT PERCENTAGES) | Years ended | | | | |
|--|--------------|--------------|--------|--------------|--------|
| | Dec 31, 2019 | Dec 31, 2018 | Change | Dec 31, 2017 | Change |
| Net income | \$ 206,479 | \$ 165,626 | 25% | \$ 160,617 | 29% |
| Adjustments on an after-tax basis: | | | | | |
| Provision for credit losses on equipment leases at Bennington’s acquisition date | 4,226 | - | N/A | - | N/A |
| Fair value adjustments related to securities and derivatives | 1,185 | 2,829 | (58%) | (217) | 646% |
| Backstop funding facility write-down | - | 4,323 | (100%) | - | N/A |
| Adjusted net income | \$ 211,890 | \$ 172,778 | 23% | \$ 160,400 | 32% |
| Dividends on preferred shares | 4,691 | 4,763 | (2%) | 4,763 | (2%) |
| Adjusted net income available to common shareholders | \$ 207,199 | \$ 168,015 | 23% | \$ 155,637 | 33% |
| Adjusted weighted average common equity | 1,303,174 | 1,143,427 | 14% | 984,759 | 32% |
| Adjusted ROE | 15.9% | 14.7% | 1.2% | 15.8% | 0.1% |

| (\$ THOUSANDS, EXCEPT PERCENTAGES) | Three months ended | | | | |
|--|--------------------|--------------|--------|--------------|--------|
| | Dec 31, 2019 | Sep 30, 2019 | Change | Dec 31, 2018 | Change |
| Net income | \$ 55,854 | \$ 54,942 | 2% | \$ 40,116 | 39% |
| Adjustments on an after-tax basis: | | | | | |
| Fair value adjustments related to securities and derivatives | 191 | (188) | 202% | 5,419 | (96%) |
| Adjusted net income | \$ 56,045 | \$ 54,754 | 2% | \$ 45,535 | 23% |
| Dividends on preferred shares | 1,118 | 1,191 | (6%) | 1,190 | (6%) |
| Adjusted net income available to common shareholders | \$ 54,927 | \$ 53,563 | 3% | \$ 44,345 | 24% |
| Adjusted weighted average common equity | 1,366,616 | 1,312,774 | 4% | 1,200,093 | 14% |
| Adjusted ROE | 15.9% | 16.2% | (0.3%) | 14.7% | 1.2% |

Reconciliation of Adjusted EPS – diluted

| (\$ PER SHARE AMOUNTS) | Years ended | | | | |
|--|--------------|--------------|--------|--------------|--------|
| | Dec 31, 2019 | Dec 31, 2018 | Change | Dec 31, 2017 | Change |
| EPS – diluted | \$ 11.97 | \$ 9.67 | 24% | \$ 9.39 | 27% |
| Adjustments on an after-tax basis: | | | | | |
| Provision for credit losses on equipment leases at Bennington’s acquisition date | 0.26 | - | N/A | - | N/A |
| Fair value adjustments related to securities and derivatives | 0.06 | 0.17 | (65%) | (0.01) | 700% |
| Backstop funding facility write-down | - | 0.26 | (100%) | - | N/A |
| Adjusted EPS – diluted | \$ 12.29 | \$ 10.10 | 22% | \$ 9.38 | 31% |

| (\$ PER SHARE AMOUNTS) | Three months ended | | | | |
|--|--------------------|--------------|--------|--------------|--------|
| | Dec 31, 2019 | Sep 30, 2019 | Change | Dec 31, 2018 | Change |
| EPS – diluted | \$ 3.21 | \$ 3.18 | 1% | \$ 2.33 | 38% |
| Adjustments on an after-tax basis: | | | | | |
| Fair value adjustments related to preferred shares and derivatives | 0.01 | (0.01) | 200% | 0.33 | (97%) |
| Adjusted EPS – diluted | \$ 3.22 | \$ 3.17 | 2% | \$ 2.66 | 21% |

Reconciliation of Adjusted Efficiency Ratio

| (\$ THOUSANDS, EXCEPT PERCENTAGES) | Years ended | | | | |
|--|--------------|--------------|--------|--------------|--------|
| | Dec 31, 2019 | Dec 31, 2018 | Change | Dec 31, 2017 | Change |
| Non-interest expenses | \$ 199,573 | \$ 149,363 | 34% | \$ 129,030 | 55% |
| Net revenue | 497,064 | 376,040 | 32% | 349,388 | 42% |
| Adjustments on a pre-tax basis: | | | | | |
| Fair value adjustments related to securities and derivatives | 1,613 | 3,849 | (58%) | (295) | 647% |
| Backstop funding facility write-down | - | 5,881 | (100%) | - | N/A |
| Adjusted net revenue | 498,677 | 385,770 | 29% | 349,093 | 43% |
| Adjusted Efficiency Ratio | 40.0% | 38.7% | 1.3% | 37.0% | 3% |

| (\$ THOUSANDS, EXCEPT PERCENTAGES) | Three months ended | | | | |
|--|--------------------|--------------|--------|--------------|--------|
| | Dec 31, 2019 | Sep 30, 2019 | Change | Dec 31, 2018 | Change |
| Non-interest expenses | \$ 54,477 | \$ 50,489 | 8% | \$ 39,233 | 39% |
| Net revenue | 134,180 | 127,849 | 5% | 94,123 | 43% |
| Adjustments on a pre-tax basis: | | | | | |
| Fair value adjustments related to securities and derivatives | 259 | (255) | 202% | 7,373 | (96%) |
| Adjusted net revenue | 134,439 | 127,594 | 5% | 101,496 | 32% |
| Adjusted Efficiency Ratio | 40.5% | 39.6% | 0.9% | 38.7% | 1.8% |

- **Assets Under Management (“AUM”)**: is the sum of total assets reported on the consolidated balance sheet and loan principal derecognized but still managed by the Company.

| (\$ THOUSANDS) | | | | | |
|--|---------------|---------------|--------|---------------|--------|
| | Dec 31, 2019 | Dec 31, 2018 | Change | Dec 31, 2017 | Change |
| Total assets on the consolidated balance sheet | \$ 28,392,452 | \$ 25,037,145 | 13% | \$ 20,634,250 | 38% |
| Loan principal derecognized | 4,612,901 | 4,373,854 | 5% | 4,018,719 | 15% |
| Assets Under Management | \$ 33,005,353 | \$ 29,410,999 | 12% | \$ 24,652,969 | 34% |

- **Book value per common share:** is calculated by dividing common shareholders' equity by the number of common shares outstanding.

| (\$ THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS) | Dec 31, 2019 | Dec 31, 2018 | Change | Dec 31, 2017 | Change |
|--|--------------|--------------|--------|--------------|--------|
| Shareholders' equity | \$ 1,467,714 | \$ 1,280,027 | 15% | \$ 1,138,117 | 29% |
| Preferred shares | (72,557) | (72,557) | -% | (72,557) | -% |
| Common shareholders' equity | 1,395,157 | 1,207,470 | 16% | 1,065,560 | 31% |
| Common shares outstanding | 16,797,593 | 16,554,018 | 1% | 16,503,437 | 2% |
| Book value per common share | \$ 83.06 | \$ 72.94 | 14% | \$ 64.57 | 29% |

- **Capital ratios:**

- **CET1 Ratio:** this key measure of capital strength is defined as CET1 Capital as a percentage of total RWA. This ratio is calculated for the Bank in accordance with the guidelines issued by OSFI. CET1 Capital is defined as shareholders' equity plus any qualifying other non-controlling interest in subsidiaries less preferred shares issued and outstanding, any goodwill, other intangible assets and cash flow hedge reserve components of accumulated other comprehensive income.
- **Tier 1 and Total Capital Ratios:** these adequacy ratios are calculated for the Bank, in accordance with the guidelines issued by OSFI by dividing Tier 1 or Total Capital by total RWA. Tier 1 Capital is calculated by adding non-cumulative preferred shares to CET1 Capital. Tier 2 Capital is equal to the sum of the Bank's eligible Stage 1 and 2 allowance. Total Capital equals to Tier 1 plus Tier 2 Capital.
- **Leverage Ratio:** this measure is calculated by dividing Tier 1 Capital by an exposure measure. The exposure measure consists of total assets (excluding items deducted from Tier 1 Capital) and certain off-balance sheet items converted into credit exposure equivalents. Adjustments are also made to derivatives and secured financing transactions to reflect credit and other risks.

A detailed calculation of all Capital ratios can be found in Table 14 of this MD&A.

- **Economic value of shareholders' equity ("EVE"):** is a calculation of the present value of the Company's asset cash flows, less the present value of liability cash flows on an after-tax basis. EVE is a more comprehensive measure of our exposure to interest rate changes than is in net interest income because it captures all interest rate mismatches across all terms.
- **Efficiency Ratio:** this measure is used to assess the efficiency of the Company's cost structure in terms of revenue generation. This ratio is derived by dividing non-interest expenses by the sum of net revenue. A lower efficiency Ratio reflects a more efficient cost structure.

| (\$ THOUSANDS, EXCEPT PERCENTAGES) | Dec 31, 2019 | Dec 31, 2018 | Change | Dec 31, 2017 | Change |
|------------------------------------|--------------|--------------|--------|--------------|--------|
| Non-interest expenses | \$ 199,573 | \$ 149,363 | 34% | \$ 129,030 | 55% |
| Net revenue | 497,064 | 376,040 | 32% | 349,388 | 42% |
| Efficiency Ratio | 40.2% | 39.7% | 0.5% | 36.9% | 3.3% |

| (\$ THOUSANDS, EXCEPT PERCENTAGES) | Dec 31, 2019 | Sep 30, 2019 | Change | Dec 31, 2018 | Change |
|------------------------------------|--------------|--------------|--------|--------------|--------|
| Non-interest expenses | \$ 54,477 | \$ 50,489 | 8% | \$ 39,233 | 39% |
| Net revenue | 134,180 | 127,849 | 5% | 94,123 | 43% |
| Efficiency Ratio | 40.6% | 39.5% | 1.1% | 41.7% | (1.1%) |

- **Liquid assets:** is a measure of the Company's cash or assets that can be readily converted into cash, which are held for the purposes of funding loans, deposit maturities, and the ability to collect other receivables and settle other obligations. A detailed calculation can be found in Table 12 of this MD&A.
- **Liquidity Coverage Ratio ("LCR"):** this ratio, calculated according to OSFI's Liquidity Adequacy Requirements, measures the Company's ability to meet its liquidity needs for a 30 calendar day liquidity stress scenario. It is equal to high-quality liquid assets divided by total net cash outflows over the next 30 calendar days.

- **Loans Under Management (“LUM”)**: is the sum of loan principal reported on the consolidated balance sheet and loan principal derecognized but still managed by the Company. A detailed calculation can be found in Table 9 of this MD&A.
- **Net interest margin (“NIM”)**: this profitability measure is calculated on an annualized basis by dividing net interest income by the average total interest earning assets for the period. A detailed calculation can be found in Tables 3 and 17 of this MD&A.
- **Net revenue**: is calculated as the sum of net interest income and other income.

| (\$ THOUSANDS) | Years ended | | | | |
|---------------------|--------------|--------------|--------|--------------|--------|
| | Dec 31, 2019 | Dec 31, 2018 | Change | Dec 31, 2017 | Change |
| Net interest income | \$ 462,648 | \$ 348,381 | 33% | \$ 308,362 | 50% |
| Other income | 34,416 | 27,659 | 24% | 41,026 | (16%) |
| Net revenue | \$ 497,064 | \$ 376,040 | 32% | \$ 349,388 | 42% |

| (\$ THOUSANDS) | Three months ended | | | | |
|---------------------|--------------------|--------------|--------|--------------|--------|
| | Dec 31, 2019 | Sep 30, 2019 | Change | Dec 31, 2018 | Change |
| Net interest income | \$ 124,827 | \$ 118,147 | 6% | \$ 94,591 | 32% |
| Other income | 9,353 | 9,702 | (4%) | (468) | 2,099% |
| Net revenue | \$ 134,180 | \$ 127,849 | 5% | \$ 94,123 | 43% |

- **Provision for credit losses (“PCL”) – rate**: this credit quality metric is calculated on an annualized basis and is defined as the provision for credit losses as a percentage of average loan principal outstanding during the period.

| (\$ THOUSANDS, EXCEPT PERCENTAGES) | Years ended | | | | |
|------------------------------------|--------------|--------------|--------|--------------|--------|
| | Dec 31, 2019 | Dec 31, 2018 | Change | Dec 31, 2017 | Change |
| Provision for credit losses | \$ 18,394 | \$ 2,083 | 783% | \$ 1,543 | 1,092% |
| Divided by: average loan principal | 25,187,572 | 21,320,697 | 18% | 18,457,267 | 36% |
| Provision for credit losses – rate | 0.07% | 0.01% | 0.06% | 0.01% | 0.06% |

| (\$ THOUSANDS, EXCEPT PERCENTAGES) | Three months ended | | | | |
|------------------------------------|--------------------|--------------|--------|--------------|--------|
| | Dec 31, 2019 | Sep 30, 2019 | Change | Dec 31, 2018 | Change |
| Provision for credit losses | \$ 3,917 | \$ 3,463 | 13% | \$ 628 | 524% |
| Divided by: average loan principal | 26,181,201 | 25,312,579 | 3% | 22,507,297 | 16% |
| Provision for credit losses – rate | 0.06% | 0.05% | 0.01% | 0.01% | 0.05% |

- **PCL – normalized**: this credit quality metric is the PCL without the impact of the one-time IFRS 9 related adjustment on equipment leases that was recorded at the time of Bennington’s acquisition.
- **Return on average assets**: this profitability measure is calculated on an annualized basis and is defined as net income as a percentage of average month-end total assets balances outstanding during the period.

| (\$ THOUSANDS, EXCEPT PERCENTAGES) | Years ended | | | | |
|------------------------------------|--------------|--------------|--------|--------------|--------|
| | Dec 31, 2019 | Dec 31, 2018 | Change | Dec 31, 2017 | Change |
| Net income | \$ 206,479 | \$ 165,626 | 25% | \$ 160,617 | 29% |
| Average total assets | 26,799,113 | 22,239,188 | 21% | 19,775,794 | 36% |
| Return on average assets | 0.8% | 0.7% | 0.1% | 0.8% | -% |

| (\$ THOUSANDS, EXCEPT PERCENTAGES) | Three months ended | | | | |
|------------------------------------|--------------------|--------------|--------|--------------|--------|
| | Dec 31, 2019 | Sep 30, 2019 | Change | Dec 31, 2018 | Change |
| Net income | \$ 55,854 | \$ 54,942 | 2% | \$ 40,116 | 39% |
| Average total assets | 27,984,188 | 27,112,180 | 3% | 24,068,090 | 16% |
| Return on average assets | 0.8% | 0.8% | -% | 0.7% | 0.1% |

- **Return on shareholders' equity ("ROE"):** this profitability measure is calculated on an annualized basis and is defined as net income available to common shareholders as a percentage of the weighted average common equity outstanding during the period.

| (\$ THOUSANDS, EXCEPT PERCENTAGES) | Years ended | | | | |
|---|--------------|--------------|--------|--------------|--------|
| | Dec 31, 2019 | Dec 31, 2018 | Change | Dec 31, 2017 | Change |
| Net income available to common shareholders | \$ 201,788 | \$ 160,863 | 25% | \$ 155,854 | 29% |
| Weighted average common equity outstanding | 1,300,468 | 1,139,851 | 14% | 984,867 | 32% |
| Return on shareholders' equity | 15.5% | 14.1% | 1.4% | 15.8% | (0.3%) |

| (\$ THOUSANDS, EXCEPT PERCENTAGES) | Three months ended | | | | |
|---|--------------------|--------------|--------|--------------|--------|
| | Dec 31, 2019 | Sep 30, 2019 | Change | Dec 31, 2018 | Change |
| Net income available to common shareholders | \$ 54,736 | \$ 53,751 | 2% | \$ 38,926 | 41% |
| Weighted average common equity outstanding | 1,366,521 | 1,312,868 | 4% | 1,197,384 | 14% |
| Return on shareholders' equity | 15.9% | 16.2% | (0.3%) | 12.9% | 3.0% |

- **Risk-weighted assets ("RWA"):** represents the Bank's assets and off-balance sheet exposures, weighted according to risk as prescribed by OSFI under the CAR Guideline. A detailed calculation can be found in Table 15 of this MD&A.
- **Total shareholder return ("TSR"):** is defined as total return of stock to an investor including stock appreciation and dividends.

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MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The consolidated financial statements of Equitable Group Inc. (the "Company") are prepared by management, which is responsible for the integrity and fairness of the information presented. The information provided herein, in the opinion of management, has been prepared, within reasonable limits of materiality, using appropriate accounting policies that are in accordance with International Financial Reporting Standard ("IFRS") as well as the accounting requirements of the Office of the Superintendent of Financial Institutions Canada ("OSFI") as these apply to its subsidiary, Equitable Bank. The consolidated financial statements reflect amounts which must, of necessity, be based on informed judgments and estimates of the expected effects of current events and transactions.

Management maintains and monitors a system of internal control to meet its responsibility for the integrity of the consolidated financial statements. These controls are designed to provide reasonable assurance that the Company's consolidated assets are safeguarded, that transactions are executed in accordance with management's authorization and that the financial records form a reliable base for the preparation of accurate and timely financial information. Management also administers a program of ethical business conduct, which includes quality standards in hiring and training employees, written policies and a written corporate code of conduct. Management responsibility also includes maintaining adequate accounting records and an effective system of risk management.

The Board of Directors of the Company (the "Board") oversees management's responsibility for the consolidated financial statements through the Audit Committee. The Audit Committee conducts a detailed review of the consolidated financial statements with management and internal and external auditors before recommending their approval to the Board.

The Company's subsidiary, Equitable Bank, is a Schedule I Bank under the Bank Act (Canada) and is regulated by OSFI. On a regular basis, OSFI conducts an examination to assess the operations of Equitable Bank and its compliance with statutory requirements and sound business practices.

KPMG LLP has been appointed as external auditors by the shareholders to examine the consolidated financial statements of the Company in accordance with Canadian generally accepted auditing standards. The external auditors are responsible for reporting on whether the consolidated financial statements are fairly presented in accordance with IFRS. The auditors have unrestricted access to and periodically meet with the Audit Committee, with and without management present, to discuss their audits and related matters.



Andrew Moor

President and Chief Executive Officer

February 24, 2020



Tim Wilson

Chief Financial Officer

INDEPENDENT AUDITORS' REPORT

To the Shareholders of Equitable Group Inc.

Opinion

We have audited the consolidated financial statements of Equitable Group Inc. (the Entity), which comprise:

- the consolidated balance sheets as at December 31, 2019 and December 31, 2018
- the consolidated statements of income and comprehensive income for the years then ended
- the consolidated statements of changes in shareholders' equity for the years then ended
- the consolidated statements of cash flows for the years then ended
- and notes to the consolidated financial statements, including a summary of significant accounting policies

(Hereinafter referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the consolidated financial position of the Entity as at December 31, 2019 and December 31, 2018, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards (IFRS).

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 "**Auditors' Responsibilities for the Audit of the Financial Statements**" section of our auditors' report.

We are independent of the Entity in accordance with the ethical requirements that are relevant to our audit of the 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. Other information comprises:

- the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions;
- the information, other than the financial statements and the auditors' report thereon, included in a document likely to be entitled "Annual Report".

Our opinion on the 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 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 financial statements or our knowledge obtained in the audit and remain alert for indications that the other information appears to be materially misstated.

We obtained the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions as at the date of this auditors' report. If, based on the work we have performed on this other information, we

conclude that there is a material misstatement of this other information, we are required to report that fact in the auditors' report.

We have nothing to report in this regard.

The information, other than the financial statements and the auditors' report thereon and the Management's Discussion and Analysis, included in a document likely to be entitled "Annual Report" is expected to be made available to us after the date of this auditors' 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 Financial Statements

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

In preparing the financial statements, management is responsible for assessing the Entity'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 Entity or to cease operations, or has no realistic alternative but to do so.

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

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' 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 the 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 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 Entity'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 Entity's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required

to draw attention in our auditors' report to the related disclosures in the 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 auditors' report. However, future events or conditions may cause the Entity to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- 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.
- Provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Entity to express an opinion on the financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.



Chartered Professional Accountants, Licensed Public Accountants

The engagement partner on the audit resulting in this auditors' report is Steven Watts.

Toronto, Canada
February 24, 2020

CONSOLIDATED BALANCE SHEETS

(\$ THOUSANDS)

| As at December 31 | Note | 2019 | 2018 |
|--|-------|----------------------|----------------------|
| Assets | | | |
| Cash and cash equivalents | 7 | \$ 508,853 | \$ 477,243 |
| Restricted cash | 7 | 462,992 | 327,097 |
| Securities purchased under reverse repurchase agreements | 8 | 150,069 | 250,000 |
| Investments | 9 | 362,611 | 193,399 |
| Loans – Retail ⁽¹⁾ | 10,11 | 18,359,805 | 16,203,137 |
| Loans – Commercial ⁽¹⁾ | 10,11 | 8,248,025 | 7,323,267 |
| Securitization retained interests | 11 | 139,009 | 115,331 |
| Other assets | 14 | 161,088 | 147,671 |
| | | \$ 28,392,452 | \$ 25,037,145 |
| Liabilities and Shareholders' Equity | | | |
| Liabilities: | | | |
| Deposits | 15 | \$ 15,442,207 | \$ 13,668,521 |
| Securitization liabilities | 11 | 10,706,956 | 9,236,045 |
| Obligations under repurchase agreements | 11 | 507,044 | 342,010 |
| Deferred tax liabilities | 16 | 54,689 | 42,610 |
| Other liabilities | 17 | 213,842 | 177,961 |
| Bank facilities | 18 | - | 289,971 |
| | | 26,924,738 | 23,757,118 |
| Shareholders' Equity: | | | |
| Preferred shares | 19 | 72,557 | 72,557 |
| Common shares | 19 | 213,277 | 200,792 |
| Contributed surplus | 20 | 6,973 | 7,035 |
| Retained earnings | | 1,193,493 | 1,014,559 |
| Accumulated other comprehensive loss | | (18,586) | (14,916) |
| | | 1,467,714 | 1,280,027 |
| | | \$ 28,392,452 | \$ 25,037,145 |

⁽¹⁾ Effective January 1, 2019, the Company has changed the presentation of its loan products (refer Note 2 (f)). Prior year presentation has been updated accordingly.

See accompanying notes to the consolidated financial statements.



David LeGresley
Chair of the Board



Andrew Moor
President and Chief Executive Officer

CONSOLIDATED STATEMENTS OF INCOME

(\$ THOUSANDS, EXCEPT PER SHARE AMOUNTS)

| Years ended December 31 | Note | 2019 | 2018 |
|--|------|-------------------|-------------------|
| Interest income: | | | |
| Loans – Retail ⁽¹⁾ | | \$ 685,964 | \$ 541,586 |
| Loans – Commercial ⁽¹⁾ | | 395,860 | 294,764 |
| Investments | | 8,671 | 5,867 |
| Other | | 26,315 | 17,846 |
| | | 1,116,810 | 860,063 |
| Interest expense: | | | |
| Deposits | | 385,197 | 290,991 |
| Securitization liabilities | 11 | 256,364 | 191,866 |
| Bank facilities | | 7,319 | 24,242 |
| Other | | 5,282 | 4,583 |
| | | 654,162 | 511,682 |
| Net interest income | | 462,648 | 348,381 |
| Provision for credit losses | 10 | 18,394 | 2,083 |
| Net interest income after provision for credit losses | | 444,254 | 346,298 |
| Other income: | | | |
| Fees and other income | | 23,855 | 21,229 |
| Net loss on investments | | (973) | (3,855) |
| Gains on securitization activities and income from securitization retained interests | 11 | 11,534 | 10,285 |
| | | 34,416 | 27,659 |
| Net interest and other income | | 478,670 | 373,957 |
| Non-interest expenses: | | | |
| Compensation and benefits | | 101,651 | 77,062 |
| Other | | 97,922 | 72,301 |
| | | 199,573 | 149,363 |
| Income before income taxes | | 279,097 | 224,594 |
| Income taxes: | 16 | | |
| Current | | 73,877 | 54,374 |
| Deferred | | (1,259) | 4,594 |
| | | 72,618 | 58,968 |
| Net income | | \$ 206,479 | \$ 165,626 |
| Dividends on preferred shares | | 4,691 | 4,763 |
| Net income available to common shareholders | | \$ 201,788 | \$ 160,863 |
| Earnings per share | 21 | | |
| Basic | | \$ 12.10 | \$ 9.73 |
| Diluted | | \$ 11.97 | \$ 9.67 |

⁽¹⁾ Effective January 1, 2019, the Company has changed the presentation of its interest income relating to loan products (refer to Note 2 (f)). Prior year presentation has been updated accordingly.

See accompanying notes to the consolidated financial statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(\$ THOUSANDS)

| Years ended December 31 | Note | 2019 | 2018 |
|---|------|------------|------------|
| Net income | | \$ 206,479 | \$ 165,626 |
| Other comprehensive income – items that will be reclassified subsequently to income | | | |
| Debt instruments at Fair Value through Other Comprehensive Income: | | | |
| Net unrealized gains from change in fair value | | 554 | 37 |
| Reclassification of net (gains) losses to income | | (315) | 17 |
| Other comprehensive income – items that will not be reclassified subsequently to income | | | |
| Equity instruments designated at Fair Value through Other Comprehensive Income: | | | |
| Net unrealized losses from change in fair value | | (1,320) | (14,505) |
| Reclassification of net (gains) losses to retained earnings | | (638) | 11 |
| | | (1,719) | (14,440) |
| Income tax recovery | | 457 | 3,831 |
| | | (1,262) | (10,609) |
| Cash flow hedges: | 12 | | |
| Net unrealized losses from change in fair value | | (894) | (2,971) |
| Reclassification of net (gains) losses to income | | (2,388) | 2,285 |
| | | (3,282) | (686) |
| Income tax recovery | | 874 | 182 |
| | | (2,408) | (504) |
| Total other comprehensive loss | | (3,670) | (11,113) |
| Total comprehensive income | | \$ 202,809 | \$ 154,513 |

See accompanying notes to the consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(\$ THOUSANDS)

| | 2019 | | | | | | | |
|--|------------------|---------------|---------------------|-------------------|------------------|---|-------------|--------------|
| | Preferred shares | Common shares | Contributed surplus | Retained earnings | Cash flow hedges | Accumulated other comprehensive income (loss) | | Total |
| | | | | | | Financial instruments at FVOCI | Total | |
| Balance, beginning of year | \$ 72,557 | \$ 200,792 | \$ 7,035 | \$ 1,014,559 | \$ 2,649 | \$ (17,565) | \$ (14,916) | \$ 1,280,027 |
| Cumulative effect of adopting IFRS 16 ⁽¹⁾ | - | - | - | (840) | - | - | - | (840) |
| Restated balance as at January 1, 2019 | 72,557 | 200,792 | 7,035 | 1,013,719 | 2,649 | (17,565) | (14,916) | 1,279,187 |
| Net income | - | - | - | 206,479 | - | - | - | 206,479 |
| Transfer of losses on sale of equity instruments | - | - | - | (469) | - | - | - | (469) |
| Other comprehensive loss, net of tax | - | - | - | - | (2,408) | (1,262) | (3,670) | (3,670) |
| Exercise of stock options | - | 10,825 | - | - | - | - | - | 10,825 |
| Dividends: | | | | | | | | |
| Preferred shares | - | - | - | (4,691) | - | - | - | (4,691) |
| Common shares | - | - | - | (21,545) | - | - | - | (21,545) |
| Stock-based compensation | - | - | 1,598 | - | - | - | - | 1,598 |
| Transfer relating to the exercise of stock options | - | 1,660 | (1,660) | - | - | - | - | - |
| Balance, end of year | \$ 72,557 | \$ 213,277 | \$ 6,973 | \$ 1,193,493 | \$ 241 | \$ (18,827) | \$ (18,586) | \$ 1,467,714 |

| | 2018 | | | | | | | |
|---|------------------|---------------|---------------------|-------------------|------------------|---|-------------|--------------|
| | Preferred shares | Common shares | Contributed surplus | Retained earnings | Cash flow hedges | Accumulated other comprehensive income (loss) | | Total |
| | | | | | | Financial instruments at FVOCI | Total | |
| Balance, beginning of year | \$ 72,557 | \$ 198,660 | \$ 6,012 | \$ 866,109 | \$ 3,153 | \$ (8,374) | \$ (5,221) | \$ 1,138,117 |
| Cumulative effect of adopting IFRS 9 ⁽²⁾ | - | - | - | 5,450 | - | 1,418 | 1,418 | 6,868 |
| Restated balance as at January 1, 2018 | 72,557 | 198,660 | 6,012 | 871,559 | 3,153 | (6,956) | (3,803) | 1,144,985 |
| Net income | - | - | - | 165,626 | - | - | - | 165,626 |
| Transfer of losses on sale of equity instruments | - | - | - | (9) | - | - | - | (9) |
| Other comprehensive loss, net of tax | - | - | - | - | (504) | (10,609) | (11,113) | (11,113) |
| Exercise of stock options | - | 1,780 | - | - | - | - | - | 1,780 |
| Dividends: | | | | | | | | |
| Preferred shares | - | - | - | (4,763) | - | - | - | (4,763) |
| Common shares | - | - | - | (17,854) | - | - | - | (17,854) |
| Stock-based compensation | - | - | 1,375 | - | - | - | - | 1,375 |
| Transfer relating to the exercise of stock options | - | 352 | (352) | - | - | - | - | - |
| Balance, end of year | \$ 72,557 | \$ 200,792 | \$ 7,035 | \$ 1,014,559 | \$ 2,649 | \$ (17,565) | \$ (14,916) | \$ 1,280,027 |

⁽¹⁾ The Company adopted IFRS 16 effective January 1, 2019 using the modified retrospective approach, with the cumulative effect of initially applying the standard recognized in opening retained earnings at the date of initial application. The adjustment of \$840 is net of tax (refer Note 3 – Changes in accounting policies).

⁽²⁾ The total adjustment of \$6,868 is net of tax. The total adjustment gross of tax is \$9,418.

See accompanying notes to the consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(\$ THOUSANDS)

| Years ended December 31 | 2019 | 2018 |
|---|--------------|-------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income | \$ 206,479 | \$ 165,626 |
| Adjustments for non-cash items in net income: | | |
| Financial instruments at fair value through income | 15,175 | 7,532 |
| Amortization of premiums/discount on investments | 2,415 | 7,829 |
| Amortization of capital assets and intangible costs | 16,999 | 9,454 |
| Provision for credit losses | 18,394 | 2,083 |
| Securitization gains | (9,888) | (9,025) |
| Stock-based compensation | 1,598 | 1,375 |
| Income taxes | 72,618 | 58,968 |
| Securitization retained interests | 31,736 | 28,481 |
| Changes in operating assets and liabilities: | | |
| Restricted cash | (93,317) | 38,941 |
| Securities purchased under reverse repurchase agreements | 99,931 | (250,000) |
| Loans receivable, net of securitizations | (2,713,778) | (4,248,509) |
| Other assets | 41,192 | (36,838) |
| Deposits | 1,763,225 | 2,544,335 |
| Securitization liabilities | 1,081,924 | 1,670,057 |
| Obligations under repurchase agreements | 165,034 | (109,991) |
| Bank facilities | (320,421) | 161,100 |
| Other liabilities | (23,108) | (11,111) |
| Income taxes paid | (48,510) | (60,663) |
| Cash flows from (used in) operating activities | 307,698 | (30,356) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Proceeds from issuance of common shares | 10,825 | 1,780 |
| Dividends paid on preferred shares | (4,691) | (4,763) |
| Dividends paid on common shares | (26,180) | (17,343) |
| Cash flows used in financing activities | (20,046) | (20,326) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Purchase of investments | (259,181) | (112,760) |
| Acquisition of subsidiary | (46,772) | - |
| Proceeds on sale or redemption of investments | 110,519 | 238 |
| Net change in Canada Housing Trust re-investment accounts | (39,848) | (57) |
| Purchase of capital assets and system development costs | (20,127) | (20,426) |
| Cash flows used in investing activities | (255,409) | (133,005) |
| Net increase (decrease) in cash and cash equivalents | 32,243 | (183,687) |
| Cash and cash equivalents, beginning of year | 476,610 | 660,930 |
| Cash and cash equivalents, end of year | \$ 508,853 | \$ 477,243 |
| Cash flows from operating activities include: | | |
| Interest received | \$ 1,073,829 | \$ 842,060 |
| Interest paid | (536,734) | (383,522) |
| Dividends received | 6,688 | 5,827 |

See accompanying notes to the consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2019 and 2018

(\$ THOUSANDS, EXCEPT SHARE, PER SHARE AND STOCK OPTION AMOUNTS)

Note 1 – Reporting Entity

Equitable Group Inc. (the “Company”) was formed on January 1, 2004 as the parent company of its wholly owned subsidiary, Equitable Bank. The Company is listed on the Toronto Stock Exchange (“TSX”) and domiciled in Canada with its registered office located at 30 St. Clair Avenue West, Suite 700, Toronto, Ontario. Equitable Bank is a Schedule I Bank under the Bank Act (Canada) and is regulated by the Office of the Superintendent of Financial Institutions Canada (“OSFI”). Equitable Bank and its subsidiaries offer savings and lending products to retail and commercial customers across Canada.

Note 2 – Basis of Preparation

(a) Statement of compliance

The Consolidated Financial Statements of Equitable Group Inc. have been prepared in accordance with International Financial Reporting Standards (“IFRS”) and Interpretations issued by the IFRS Interpretations Committee, as published by the International Accounting Standards Board (“IASB”).

The consolidated financial statements were authorized for issue by the Company’s Board of Directors on February 24, 2020.

(b) Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis except for the following items which are stated at fair value: derivative financial instruments, financial assets and liabilities that are classified or designated as at fair value through profit and loss and fair value through other comprehensive income.

(c) Functional currency

The functional currency of the Company and its subsidiaries is Canadian dollars, which is also the presentation currency of the consolidated financial statements.

(d) Use of estimates and accounting judgments in applying accounting policies

The preparation of the consolidated financial statements 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 dates of the consolidated financial statements and the reported amounts of revenue and expenses during the years. Estimates and underlying assumptions are reviewed by management on an ongoing basis. The critical estimates and judgments utilized in preparing the Company’s consolidated financial statements affect the assessment of the allowance for credit losses on loans, impairment of other financial instruments, fair values of financial assets and liabilities, derecognition of financial assets transferred in securitization transactions, effectiveness of financial hedges for accounting purposes and income taxes.

In making estimates and judgments, management uses external information and observable market conditions where possible, supplemented by internal analysis as required. These estimates and judgments have been applied in a manner consistent with prior periods and there are no known trends, commitments or events that we believe will materially affect the methodology or assumptions utilized in making these estimates and judgments in these consolidated financial statements. Actual results could differ from these estimates, in which case the impact would be recognized in the consolidated financial statements in future periods.

Allowance for credit losses 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 since initial recognition and in estimating the amount of expected credit losses. The calculation of expected credit losses

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2019 and 2018

(\$ THOUSANDS, EXCEPT SHARE, PER SHARE AND STOCK OPTION AMOUNTS)

includes the incorporation of forward-looking forecasts of future economic conditions, 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 modelling process. Changes in these inputs, assumptions, models, and judgements directly impact the measurement of ECLs.

(e) Consolidation

The consolidated financial statements as at and for the twelve months ended December 31, 2019 and December 31, 2018 include the assets, liabilities and results of operations of the Company and its subsidiaries, after the elimination of intercompany transactions and balances. The Company has control of its subsidiaries as it is exposed to and has rights to variable returns from its involvement with the subsidiaries and it has the ability to affect those returns through its power over their relevant activities.

(f) Change in presentation

Effective January 1, 2019, the Company has changed the presentation of its loan products based on Retail and Commercial lending. In the prior years, the Company presented these loans as Mortgages based on Core lending and Securitization financing. A similar change has been made in the Consolidated Statements of Income for presenting related interest income. Prior year presentation has also been updated accordingly. This change in presentation better aligns the Company's loan products with its customer segments and the way it manages its business.

Note 3 – Significant Accounting Policies

The following note describes the Company's significant accounting policies. These accounting policies have been applied consistently to all periods presented in these consolidated financial statements, except for:

- i) changes in the accounting policies resulting from the adoption of International Financial Reporting Standards 16, Leases ("IFRS 16"); and
- ii) adoption of new accounting policies as a result of acquisition of a subsidiary in the current year (refer to Note 5).

As a result, the Company has changed its accounting policies and adopted new accounting policies, as outlined below.

Changes in accounting policies

IFRS 16 – As a Lessee

The Company adopted IFRS 16 effective January 1, 2019. Prior to adoption of IFRS 16, premises leased by the Company were classified as operating leases under IAS 17, Leases. IFRS 16 introduces a single, on-balance sheet accounting model for leases that requires recognition of a Right-of-Use ("ROU") asset and a corresponding lease liability. As a result of adoption of the new standard, the Company changed its accounting policies relating to its operating leases. As permitted by the transition provisions of IFRS 16, the Company elected to use the modified retrospective approach and not to restate comparative period results, therefore all comparative period information is presented in accordance with our previous accounting policies. Adjustments relating to the recognition of ROU assets and related liabilities, at the date of initial application have been recognized in opening retained earnings for the current year. New disclosures have been provided for the current year, where applicable, while comparative year disclosures are consistent with those made in prior years.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2019 and 2018

(\$ THOUSANDS, EXCEPT SHARE, PER SHARE AND STOCK OPTION AMOUNTS)

Identification of a lease

At the inception of a contract, the Company assesses whether the contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. To assess if the contract conveys the right to control the use of an identified asset, the Company assesses whether:

- the contract involves the use of an identified asset – this may be specified explicitly or implicitly in the contract, and is physically distinct or represents substantially all of the capacity of a physically distinct asset. If the supplier has a substantive substitution right, then the asset is not considered as identified;
- the Company has the right to obtain substantially all of the economic benefits from the use of the asset throughout the period of use; and
- the Company has the right to direct the use of the asset. The Company has this right when it has the decision-making rights that are most relevant to changing the purpose of the asset use throughout the period of use.

Recognition

The Company recognizes a ROU asset and a lease liability at the lease commencement date. The ROU asset is initially measured at cost, which comprises the initial amount of lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred, less any lease incentives received.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if the rate cannot be readily determined, the Company's incremental borrowing rate.

Subsequent measurement

The ROU asset is subsequently depreciated using the straight-line method from the commencement date to the earlier of the end of the useful life of the ROU asset or the end on the lease term. In addition, the ROU asset is periodically reduced by impairment losses, if any, and adjusted for certain remeasurements of the lease liability.

The lease liability is measured at amortized cost using the effective interest method. The liability is remeasured if there are changes to the lease rates, or changes to the Company's assessment of whether it will exercise the extension or termination options per the lease contracts.

After the commencement date, if a lease is remeasured, an adjustment is made to the ROU asset. In case the carrying amount of the ROU asset is reduced to zero and there is a further reduction in the measurement of the lease liability, the remaining amount is recognized in the income statement.

The ROU assets and corresponding lease liabilities are included in Other Assets and Other Liabilities, on the Company's Consolidated Balance Sheets.

Short-term leases and leases of low-value assets

The Company has elected not to recognize a ROU asset and lease liabilities for short-term leases that have a lease term of 12 months or less and leases of low-value assets. The Company recognizes the lease payments associated with these leases as an expense on a straight-line basis over the lease term.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2019 and 2018

(\$ THOUSANDS, EXCEPT SHARE, PER SHARE AND STOCK OPTION AMOUNTS)

New accounting policies adopted

The Company acquired a new equipment leasing line of business on January 1, 2019 (refer Note 5). Accordingly, the Company has adopted the following new accounting policies:

IFRS 16 – As a Lessor

Identification of a lease

At the inception of each lease, the Company assesses if it is a finance lease or an operating lease. The assessment is based on substantially transferring all the risks and rewards to the lessee. If substantially all of the risks and rewards incidental to ownership are transferred to the lessee, then the lease is a finance lease, else it is an operating lease.

Recognition

At the lease commencement date, the Company includes assets held under a finance lease in Loans – Commercial, on its Consolidated Balance Sheets at an amount equal to the net investment in the finance lease. The investment in finance lease is initially measured at the present value of the lease payments that are not received at the commencement date, discounted using the interest rate implicit in the lease, which is adjusted for all the initial direct costs associated with the origination of finance lease that are factored into the determination of the interest rate implicit in the lease. Lease payments included in the measurement of investment in finance lease include fixed and variable lease payments, less incentives payable.

Subsequent measurement

The net investment in finance leases includes gross minimum lease payments receivable, less the unamortized portion of unearned finance income, security deposits held, and the allowance for credit losses. The finance income earned is included in Interest income – Commercial Loans in the Consolidated Statements of Income on a basis that reflects a constant periodic rate of return on the gross investment in finance lease receivables.

Business combinations and goodwill

Business combinations are accounted for using the acquisition method. Non-controlling interests, if any, are recognized at their proportionate share of the fair value of identifiable assets and liabilities. Goodwill represents the excess purchase price paid over the fair value of identifiable net assets and liabilities acquired in a business combination on the date of acquisition.

Goodwill is allocated to cash-generating units for the purpose of impairment testing, which is the lowest level at which goodwill is monitored for internal management purposes. Impairment testing is performed at least annually and when an event or change in circumstances indicates that the carrying amount may be impaired. Goodwill is carried at cost less accumulated impairment losses and is included in Other assets on the Consolidated Balance Sheets.

Purchased loans

All purchased financial assets are initially measured at fair value on the date of acquisition. As a result, no allowance for credit losses is recognized in the purchase price equation at the acquisition date.

Fair value of loans is determined by estimating the principal and interest cash flows expected to be collected and discounting those cash flows at a market rate of interest. The fair value adjustment set up for these loans on the date of acquisition is amortized over the life of these loans and included in Interest income – Loans – Commercial in the Consolidated Statements of Income.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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On the date of acquisition, purchased performing loans follow the same accounting treatment as originated performing loans, and are included in Stage 1. As a result, immediately after the date of acquisition, a 12 month allowance is recorded in provision for credit losses in the Consolidated Statements of Income. Subsequent to the acquisition date, ECL allowances are estimated in a manner consistent with our impairment policies that we apply to loans that we originate.

Purchased credit impaired loans are reflected in Stage 3 and are subject to lifetime allowance for credit losses. Any changes in expected cash flows since the date of acquisition are recorded as a charge/recovery in the provision for credit losses in the Consolidated Statements of Income.

Securitized leases

The Company securitizes pools of finance leases on a fully serviced basis, to independent third parties. The Company retains the servicing responsibilities and participates in certain cash flows from the pools. The securitization transaction is not considered to have transferred the risks and rewards of ownership and accordingly is not derecognized. The securitized finance leases continue to be classified as finance leases on the Company's Consolidated Balance Sheets, with a corresponding lease financing liability.

Accounting policies consistently applied in prior and current periods

(a) Financial instruments

The Company's consolidated balance sheet consists primarily of financial instruments and the majority of net income is derived from income and expenses, as well as gains and losses related to the respective financial instruments.

Financial instrument assets include cash and cash equivalents, restricted cash, securities purchased under reverse repurchase agreements, investments, loans receivable – retail, loans receivable – commercial, securitization retained interests and derivative financial instruments. Financial instrument liabilities include deposits, securitization liabilities, obligations under repurchase agreements, accounts payable, bank facilities and derivative financial instruments.

(i) Classification and measurement of financial instruments

Financial assets are measured at initial recognition at fair value, and are classified and subsequently measured at fair value through profit or loss ("FVTPL"), fair value through other comprehensive income ("FVOCI") or amortized cost ("AMC"), based on the business model for managing the financial instruments and the contractual cash flow characteristics of the instrument.

i. Debt Instruments

On initial recognition, all debt instruments, including loans, are classified based on:

- The business model under which the asset is held; and
- The contractual cash flow characteristics of the financial instrument

Business model assessment

Business model assessment involves determining whether financial assets are held and managed by the Company for generating and collecting contractual cash flows, selling the financial assets or both. The Company assesses the business model at a portfolio level using judgment and is supported by relevant objective evidence including:

- how the performance of the asset is evaluated and reported to the Company's management;
- the frequency, volume, reason and timing of sales in prior periods and expectations about future sales activity;

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- whether the assets are held for trading purposes i.e., assets that are acquired by the Company principally for the purpose of selling or repurchase in the near term, or held as part of a portfolio that is managed together for short-term profits; and
- the risks that affect the performance of assets held within a business model and how those risks are managed.

Cash flow characteristics assessment

The contractual cash flow characteristics assessment involves assessing the contractual features of an instrument to determine if they give rise to cash flows that are consistent with a basic lending arrangement i.e. if they represent cash flows that are solely payments of principal and interest (“SPPI”).

Principal is defined as the fair value of the instrument at initial recognition. Principal may change over the life of the instruments due to repayments. Interest is defined as consideration for the time value of money and the credit risk associated with the principal amount outstanding and for other basic lending risks and costs (liquidity risk and administrative costs), as well as a profit margin.

In assessing whether the contractual cash flows are SPPI, the Company considers the contractual terms of the instrument. This includes assessing whether the financial asset contains any contractual terms that could change the timing or amount of contractual cash flows such that the financial asset would not meet the SPPI criteria. In making the assessment the Company considers:

- contingent events that would change the amount and/or timing of cash flows;
- leverage features;
- prepayment and extension terms;
- associated penalties relating to prepayments;
- terms that limit the Company’s claim to cash flows from specified assets; and
- features that modify consideration of the time value of money.

Debt instruments measured at AMC

Debt instruments are measured at AMC using the effective interest rate, if they are held within a business model whose objective is to hold the financial asset for collecting contractual cash flows where those cash flows represent SPPI. The effective interest rate is the rate that discounts estimated future cash payments or receipts through the expected life of the financial asset to the gross carrying amount of the financial asset. AMC is calculated taking into account any discount or premium on acquisition, transaction costs and fees that are an integral part of the effective interest rate. Amortization of these deferred costs is included in Interest income in the Consolidated Statements of Income.

Impairment on debt instruments measured at AMC is calculated using the expected credit loss approach. Loans and debt securities measured at amortized cost are presented net of the Allowance for Credit Losses (“ACL”) in the Consolidated Balance Sheets.

Debt instruments measured at FVOCI

Debt instruments are measured at FVOCI if they are held within a business model whose objective is to hold the financial asset for collection of contractual cash flows and for selling financial assets, where the cash flows represent payments that are SPPI. Subsequent to initial recognition, the assets are fair valued and unrealized gains and losses are recorded in other comprehensive Income (“OCI”). Upon derecognition, realized gains and losses are reclassified from OCI and recorded in other income in the Consolidated Statements of Income. Premiums, discounts and related transaction costs are amortized over the expected life of the instrument to investments income in the Consolidated Statements of Income using the effective interest rate method.

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Impairment on debt instruments measured at FVOCI is calculated using the expected credit loss approach. The ACL on debt instruments measured at FVOCI does not reduce the carrying amount of the asset in the Consolidated Balance Sheets, which remains at its fair value. Instead, an amount equal to the impairment is recognized in accumulated other comprehensive income ("AOCI") with a corresponding charge to Provision for credit losses in the Consolidated Statements of Income. The accumulated allowance recognized in AOCI is recycled to the Consolidated Statements of Income upon derecognition of the debt instrument.

Debt instruments measured at FVTPL

Debt instruments measured at FVTPL include assets held as part of a portfolio managed on a fair value basis and assets whose cash flows do not represent payments that are SPPI. These instruments are measured at fair value in the Consolidated Balance Sheets, with transaction costs recognized immediately in the Consolidated Statements of Income as part of other income. Realized and unrealized gains and losses are recognized as part of other income in the Consolidated Statements of Income.

ii. Equity instruments

Equity instruments are measured at FVTPL, unless they are not held for trading purposes and an irrevocable election is made to designate these instruments at FVOCI upon initial recognition. The measurement election is made on an instrument-by-instrument basis. Changes in fair value are recognized as part of Investments income in the Consolidated Statements of Income for equity instruments measured as at FVTPL. The Company has elected to measure certain equity investments at FVOCI that are held for longer term investment purposes. These instruments are measured at fair value in the Consolidated Balance Sheets, with transaction costs being added to the cost of the instrument. Dividends received that represent return on capital, are recorded in Investments income in the Consolidated Statements of Income. Unrealized fair value gains/losses are recognized in OCI and are not subsequently reclassified to the Consolidated Statements of Income when the instrument is derecognized or sold.

iii. Financial assets and liabilities designated at FVTPL

Financial assets and financial liabilities classified in this category are those that have been designated by the Company on initial recognition. Financial assets are designated at FVTPL if doing so eliminates or significantly reduces an accounting mismatch which would otherwise arise.

Financial liabilities are designated at FVTPL when one of the following criteria is met:

- The designation eliminates or significantly reduces an accounting mismatch which would otherwise arise; or
- The financial liability contains one or more embedded derivatives which significantly modify the cash flows otherwise required.

Financial assets and financial liabilities designated at FVTPL are recorded in the Consolidated Balance Sheets at fair value. For assets designated at FVTPL, changes in fair values are recognized in other income in the Consolidated Statements of Income. For liabilities designated at FVTPL, all changes in fair value are recognized in other income in the Consolidated Statements of Income, except for changes in fair value arising from changes in the Company's own credit risk are recognized in OCI and are not subsequently reclassified to the Consolidated Statements of Income upon derecognition/extinguishment of the liabilities.

iv. Financial liabilities

Financial liabilities are initially recognized at fair value and are subsequently measured at amortized cost, except for liabilities mandatorily measured/designated as at FVTPL.

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(ii) Impairment

Scope

The Company applies the three-stage approach to measure ACL, using the expected credit loss impairment approach as required under IFRS 9, for the following categories of financial instruments that are not measured at FVTPL:

- Financial assets at AMC
- Debt securities as at FVOCI; and
- Off-balance sheet loan commitments

The expected credit loss is calculated based on the stage in which the financial instruments falls at the reporting date. The financial instruments migrate through the three stages based on the change in their risk of default since initial recognition.

Expected credit loss (“ECL”) impairment model

The Company’s ACL calculations are outputs of an ECL model with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. The ECL impairment model reflects the present value of all cash shortfalls related to default events either (i) over the following twelve months or (ii) over the expected life of the financial instrument depending on credit deterioration of the instrument since its inception. The ACL calculated using the ECL model reflects an unbiased, probability-weighted credit loss which considers multiple scenarios based on reasonable and supportable information about past events, current conditions and forecasts of future economic conditions. Forward-looking information is explicitly incorporated into the estimation of ECL.

Measurement of ECL

The ECL impairment model measures the credit losses using the following three-stage approach based on the extent of credit deterioration of the financial assets since initial recognition:

- Stage 1 – Where there has not been a significant increase in credit risk (“SICR”) since initial recognition of a financial instrument, an amount equal to twelve months ECL is recorded. The ECL is computed using a probability of default (“PD”) occurring over the next twelve months. For those instruments with a remaining maturity of less than twelve months, a probability of default corresponding to remaining term to maturity is used.
- Stage 2 – When a financial instrument experiences a SICR subsequent to initial recognition but is not considered to be in default, it is included in Stage 2. This requires the computation of ECL based on the PD over the remaining estimated life of the financial instrument.
- Stage 3 – Financial instruments that are considered to be in default are included in this stage. Similar to Stage 2, the ACL captures lifetime ECL.

The PD, exposure at default (“EAD”), and loss given default (“LGD”) are inputs used to estimate the ECL, and are modelled using macroeconomic factors that are closely related with credit losses in the relevant portfolios, and are probability-weighted using five scenarios.

Details of these statistical parameters/inputs are as follows:

- PD is an estimate of the likelihood of default over a given time horizon, and is expressed as a percentage.
- EAD is the expected exposure in the event of default at a future default date, and is expressed as an amount.
- LGD is an estimate of the loss arising in case where a default occurs at a given time and is based on the difference between the contractual cash flows due and those that the Company would expect to receive, including from the realization of any collateral. It is expressed as a percentage of the EAD.

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Forward-looking information ("FLI")

The measurement of ACL for each stage and the assessment of SICR considers information about past events and current conditions as well as reasonable and supportable forecasts of future events and economic conditions. The estimation and application of FLI requires significant judgement.

Macroeconomic factors

The Company relies on a broad range of forward looking macroeconomic factors, such as expected GDP growth, unemployment rates, house price indices, commercial property index and family income. The inputs used in the model for calculating ECL may not always capture all characteristics of the market at the balance sheet date. To capture portfolio characteristics and risks, qualitative adjustments or overlays are made using management judgement.

Multiple forward-looking scenarios

The Company determines ECL using five probability-weighted forward-looking scenarios obtained on a periodic basis from an external third party. These scenarios include a 'base-case' scenario which represents the most likely outcome and four additional scenarios representing more optimistic and more pessimistic outcomes. These additional scenarios are designed to capture material non-linearity of potential credit losses in portfolios.

Assessment of significant increase in credit risk

The determination of whether the ECL on a financial instrument is calculated on a twelve month period or lifetime basis is dependent on the stage the financial asset falls into at the reporting date. A financial instrument moves across stages based on an increase or decrease in its risk of default at the reporting date compared to its risk of default at initial recognition, as measured by changes to borrower level information and macroeconomic outlook.

When determining whether the risk of default on a financial instrument has increased significantly since initial recognition, the Company considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis, based on the Company's historical experience and expert credit assessment, delinquency and monitoring, and macroeconomic outlook including forward-looking information. With regards to delinquency and monitoring, there is a rebuttable presumption that the risk of default of the financial instrument has significantly increased since initial recognition when contractual payments are more than 30 days overdue.

Modified financial assets

The original terms of a financial asset may be renegotiated or otherwise modified, resulting in changes to the contractual terms of the financial asset that affect the contractual cash flows.

If the terms of a financial asset are modified or an existing financial asset is replaced with a new one, an assessment is made to determine if the modification is substantial. If the modification is substantial, the original asset is derecognized and a new asset is recognized at fair value. The new financial asset is generally recorded in Stage 1, unless it is determined to be credit-impaired at the time of the renegotiation. Where the modification does not result in derecognition, the date of the origination continues to be used to determine the significant increase in credit risk.

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Definition of default

The Company considers a financial instrument to be in default when:

- the borrower is unlikely to pay its credit obligations to the Company in full, without recourse by the Company to actions such as realizing collateral (if any is held); or
- the borrower is past due more than 90 days on any material credit obligation to the Company.

The Company classifies a loan receivable as impaired when, in the opinion of management, there is a reasonable doubt as to the timely collectability, either in whole or in part, of principal or interest, or the loan is past due 90 days.

(iii) Determination of fair value of financial instruments

When a financial instrument is initially recognized, its fair value is 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.

Subsequent to initial recognition, for financial instruments measured at fair value where active market prices are available, bid prices are used for financial assets and ask prices for financial liabilities. For those financial instruments measured at fair value where an active market is not available, fair value estimates are determined using valuation methods which maximize use of observable market data and include discounted cash flow analysis and other commonly used valuation techniques. See Note 6 for the valuation methods and assumptions used to estimate fair values of financial instruments.

(iv) Derecognition of financial instruments

Financial assets

The Company derecognizes a financial asset when:

- the contractual rights to receive the cash flows from the asset have expired; or
- the Company has transferred its rights to receive future cash flows of the financial asset, or it retains the contractual rights to receive the cash flows of the financial asset but assumes a contractual obligation to pay the cash flows to one or more recipients and either:
- the Company has transferred substantially all the risks and rewards of ownership of the financial asset; or
- the Company has neither retained nor transferred substantially all the risks and rewards of ownership in the financial asset, but has transferred control of the asset.

Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Company is recognized as a separate asset or liability in the Consolidated Balance Sheets. On derecognition of a financial asset the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset transferred), and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognized in OCI is recognized in the Consolidated Statements of Income.

If the transfer of assets does not meet the criteria for derecognition, the Company continues to recognize the financial asset and also recognizes a financial liability for the consideration received upon the transfer in the Consolidated Balance Sheets.

The derecognition criteria is also applied to the transfer of part of an asset, rather than a whole, or to a group of similar financial assets in their entirety, when applicable. When it is applied to part of an asset, the part comprises of specifically identified cash flows, a fully proportionate share of the asset, or a fully proportionate share of a specifically identified cash flow from the asset.

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Financial liabilities

The Company derecognizes a financial liability when the obligation under the liability is discharged, cancelled or expires.

(v) Offsetting

Financial assets and liabilities are offset and the net amount presented in the Consolidated Balance Sheets when the Company has a legal right to set off the recognized amounts and it intends either to settle on a net basis or to realize the asset and settle the liability simultaneously. Income and expenses are presented on a net basis only when permitted under IFRS or for gains and losses arising from a group of similar transactions.

(b) Investments

Investments are accounted for at settlement date and initially measured at fair value and subsequently measured depending upon their classification as follows:

- Debt investment securities classified as at AMC; these investments are subsequently measured at amortized cost using the effective interest method;
- Debt securities classified as at FVOCI; these investments are subsequently measured at fair value, with the fair value changes recorded in other comprehensive income and moved to the Consolidated Statements of Income on derecognition;
- Debt and Equity investment securities classified as at FVTPL; these investments are subsequently measured at fair value, with the fair value changes recorded in the Consolidated Statements of Income; and
- Equity investment securities designated as at FVOCI; these investments are subsequently measured at fair value, with the fair value changes recorded in other comprehensive income and moved to retained earnings on derecognition.

For debt securities measured at FVOCI, gains and losses are recognized in OCI, except for the following, which are recognized in Consolidated Statements of Income in the same manner as for financial assets measured at amortized cost:

- Interest revenue using the effective interest method; and
- ACL and reversals.

When a debt security measured at FVOCI is derecognized, the cumulative gain or loss previously recognized in OCI is classified from OCI to Consolidated Statements of Income.

The Company elects to present changes in the fair value of certain investments in equity instruments that are not held for trading, through OCI. The election is made on an instrument-by-instrument basis on initial recognition and is irrevocable. Gains and losses on such equity instruments are never reclassified to Consolidated Statements of Income and no impairment is recognized in Consolidated Statements of Income. Dividends are recognized in Consolidated Statements of Income, unless they clearly represent a recovery of part of the cost of investment, in which case they are recognized in OCI. Cumulative gains and losses recognized in OCI are transferred to retained earnings on disposal of the investment.

(c) Loans receivable

Loans receivable measured at amortized cost

Loans are initially recognized at fair value and subsequently measured at amortized cost, plus accrued interest, using the effective interest rate method, and are reported net of unamortized origination fees, commitment income, premiums or discounts and an allowance for expected credit losses. Net fees relating to loan origination are amortized to income on an

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effective yield basis over the term of the loans to which they relate, and are included in Interest income – loans in the Consolidated Statements of Income.

Loans receivable measured as at FVTPL

Certain loans measured as at FVTPL are carried at fair value with changes in fair value included in Interest Income – Loans in the Consolidated Statements of Income. Net fees relating to loan origination are recognized in income as incurred, and are included in Interest income – Loans in the Consolidated Statements of Income.

(d) Cash and cash equivalents

Cash and cash equivalents consist of deposits with regulated financial institutions and highly liquid short-term investments, including government guaranteed investments and other money market instruments, whose term to maturity at the date of purchase is less than three months and are readily convertible to known amounts of cash which are subject to an insignificant risk of changes in value. Interest earned on cash and cash equivalents is included in Interest income – other in the Consolidated Statements of Income.

(e) Securities purchased under reverse repurchase agreements

Securities purchased under reverse repurchase agreements represent purchases of Government of Canada guaranteed debt securities and are treated as collateralized lending transactions as they represent the purchase of securities with a simultaneous agreement to sell them back at a specified price on a specified future date, which is generally short term. These receivables in respect of the amount advanced are classified and measured as at amortized cost plus accrued interest on the Consolidated Balance Sheets. The interest income related to these investments is recorded on an accrual basis using the effective interest method and is included in Interest income – Investments in the Consolidated Statements of Income.

(f) Securitizations

In the normal course of business, the Company securitizes insured residential loans through the Government of Canada's National Housing Act ("NHA"), Mortgage Backed Securities ("MBS") and Canada Mortgage Bond ("CMB") programs, which are facilitated by Canada Mortgage and Housing Corporation ("CMHC"). The Company securitizes the loans through the creation of MBS and the ultimate sale of MBS to third party investors or through the CMB program.

The Company also securitizes uninsured residential loans by entering into an agreement to sell these loans into a program sponsored by another major Schedule I Canadian bank.

Securitized loans and securitization liabilities

Insured loans in MBS that are sold to third parties and do not qualify for derecognition continue to be classified as Loans receivable on the Consolidated Balance Sheets and they are measured at amortized cost, plus accrued interest, and are reported net of unamortized origination fees, commitment income, premiums or discounts and insurance costs. Net fees and any premium or discount relating to loan origination are amortized to income on an effective yield basis over the term of the loans to which they relate, and are included in Interest income – Loans in the Consolidated Statements of Income.

Sale of uninsured residential loans do not qualify for derecognition and are classified as Loans receivable on the Consolidated Balance Sheets, and are measured at amortized cost, plus accrued interest, and are reported net of unamortized origination fees, commitment income, premiums or discounts. Net fees and any premium or discount relating to loan origination are amortized to income on an effective yield basis over the term of the loans to which they relate, and are included in Interest income – Loans in the Consolidated Statements of Income.

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In addition, these transactions are considered secured financing and result in the recognition of securitization liabilities. Securitization liabilities are measured at amortized cost, plus accrued interest, and are reported net of any unamortized premiums or discounts and transaction costs incurred in obtaining the secured financing. Interest expense is allocated over the expected term of borrowing by applying the effective interest rate to the carrying amount of the liability. Securitization retained interest and servicing liability

In certain securitization transactions that qualify for derecognition, the Company has a continuing involvement in the securitized asset that is limited to retained rights in future excess interest and the liability associated with servicing these assets. Under IFRS 9, the securitization retained interest is classified as at AMC. The servicing liability is reported as part of Other liabilities. During the life of the securitization, as cash is received, the retained interests and the servicing liability are amortized and recognized in the Consolidated Statements of Income under Gains on securitization activities and income from securitization retained interests.

Gains on securitization

When an asset is derecognized, the related loans are removed from the Consolidated Balance Sheets and a gain or loss is recognized in the Consolidated Statements of Income under Other income – Gains on securitization activities and income from securitization retained interests.

(g) Derivative financial instruments

The Company uses derivative financial instruments primarily to manage exposure to interest rate risk. Derivative instruments that are typically used are interest rate swaps, and bond forwards, and total return swaps. Interest rate swaps are used to adjust exposure to interest rate risk by modifying the maturity characteristics of existing assets and liabilities. Bond forwards are used to hedge interest rate exposures resulting from changes in interest rates between the time the Company commits to funding a loan it intends to securitize through the MBS and CMB program, and the date of securitization. Total return swaps are used to hedge the risk of changes in future cash flows related to the Company's Restricted share unit ("RSU") and Deferred share unit ("DSU") plan. The Company also uses total return swaps to hedge the reinvestment risk between the amortizing MBS and the bullet CMB related to its CMB activities.

Derivatives embedded in other financial instruments or host contracts are treated as separate derivatives when the following conditions are met:

- their economic characteristics and risks are not closely related to those of the host contract;
- a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
- the combined contract is not held for trading or designated at fair value through income.

Separated embedded derivatives are presented with other derivative assets and liabilities in the Consolidated Balance Sheets.

Cash flow hedges

In order for a derivative to qualify as an accounting hedge, the hedging relationship must be designated and formally documented at its inception, detailing the particular risk management objective and strategy for the hedge and the specific asset, liability, or cash flow being hedged, the hedging instrument, as well as how its effectiveness is being assessed. Changes in the fair value of the derivative must be highly effective in offsetting changes in the amount of future cash flows being hedged.

The Company's cash flow hedges include hedges of anticipated highly probable cash flows on fixed rate liabilities arising from accounting for securitization transactions as secured financing under IAS 39, Financial Instruments: Recognition and Measurement. The Company enters into bond forwards (including certain embedded derivatives) to hedge this cash flow risk

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and applies hedge accounting to these derivative financial instruments. The Company also enters into interest rate swaps to hedge future cash flows related to its floating rate liabilities. To the extent that changes in the fair value of the derivative do not exceed the changes in the fair value of the hedged item they are recorded in OCI, net of tax. The cumulative amounts deferred in AOCI are reclassified to Interest expense – Securitization liabilities in the Consolidated Statements of Income, over the term of the related hedged item.

The Company's cash flow hedges also include Total return equity swap contracts ("TRS") used to hedge the risk of changes in future cash flows related to its RSU plan. The value of RSUs or Performance Share Units ("PSU") issued is linked to the price of the Company's common shares over the period the TRS is in effect. The fair value of the TRS is included in Other assets and/or Other liabilities in the Consolidated Balance Sheets and the effective portion of the changes in fair values of these TRS is recorded in OCI, net of tax. The cumulative amounts deferred in AOCI are reclassified to Non-interest expense – Compensation and benefits in the Consolidated Statements of Income, over the vesting period of the RSUs or PSUs.

Hedge effectiveness is evaluated at the inception of the hedging relationship and on an ongoing basis, retrospectively and prospectively, primarily using quantitative statistical measures of correlation. The change in the fair value of the hedging instrument will be recorded on the Consolidated Balance Sheets under AOCI as either deferred gains or losses during the hedge term only to the extent of the effective portion of the hedges. Any ineffectiveness in the hedging relationship, occurring as a result of mismatch in critical terms such as tenor and timing of cash flows between hedging instruments and hedged items, is included in Other income – Gains on securitization activities and income from securitization retained interests in the Consolidated Statements of Income as it occurs.

The Company also uses TRSs to hedge the risk of changes in future cash flows related to its DSU plan and the Company has not applied hedge accounting to these derivative instruments. The value of the DSU is linked to the price of the Company's common shares over the period the TRS is in effect. The fair value of the TRS is included in Other assets and/or Other liabilities in the Consolidated Balance Sheets and changes in fair value of these TRSs being recorded in Non-interest expense – Compensation and benefits in the Consolidated Statements of Income for the period in which the changes occur.

Fair value hedges

The Company enters into interest rate swap agreements to manage interest rate exposures on fixed rate deposits used to fund floating rate loans. The fair values of these interest rate swap agreements are included in Other assets and/or Other liabilities with changes in fair value recorded in Interest expense – Deposits. Changes in the fair value of deposits attributable to the hedged risks are also included in Interest expense – Deposits. For most hedging relationships, the Company has applied hedge accounting.

The Company also enters into interest rate swap agreements to manage interest rate exposures on fixed rate securitization liabilities. The fair value of these interest rate swap agreements is included in Other assets and/or Other liabilities with changes in fair value recorded in Other income – Gains on securitization activities and income from securitization retained interests. Changes in fair value of the securitization liability attributable to the hedged risk, is also included in Other income – Gains on securitization activities and income from securitization retained interests. The Company applies hedge accounting to these derivatives.

Starting this year, the Company entered into interest rate swap agreements to manage interest rate exposures on fixed rate loan assets. The fair value of these interest rate swap agreements is included in Other assets and/or Other liabilities with changes in fair value recorded in Loans – Retail and /or Loans – Commercial. Changes in fair value of the loan assets attributable to the hedged risk, is also included in Loans – Retail and/or Loans – Commercial. The Company applies hedge accounting to these derivatives.

In order for a derivative to qualify as an accounting hedge, the hedging relationship must be designated and formally documented at its inception, detailing the particular risk management objective and strategy for the hedge and the specific asset, liability or cash flow being hedged, the hedging instrument, as well as how its effectiveness is being assessed. Changes

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in the fair value of the derivative must be highly effective in offsetting changes in the fair value of the hedged asset or liability. Hedge effectiveness is evaluated at the inception of the hedging relationship and on an ongoing basis, retrospectively and prospectively, primarily using quantitative statistical measures of correlation. Hedge ineffectiveness, if any, are as a result of differences in maturities and prepayment frequency between hedging instruments and hedged items.

The Company enters into bond forwards to manage interest rate exposures for certain loan commitments and funded loans until the date they are securitized. The fair values of these bond forwards are included in Other assets and/or Other liabilities with changes in fair value recorded in Other income – Gains on securitization activities and income from securitization retained interests. Changes in fair value of loans and loan commitments are also included in Other income – Gains on securitization activities and income from securitization retained interests. The Company does not apply hedge accounting to these derivative instruments.

The Company's hedging activities are transacted with approved counterparties, which are limited to Canadian chartered banks, their subsidiaries and other financial intermediaries.

(h) Compensation plans

The Company offers several benefit programs to eligible employees. These benefits include a deferred profit sharing plan, employee stock purchase plan, annual bonuses, and compensation in the form of share-based payments.

(i) Short-term employee benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognized for the amount expected to be paid under short-term bonus plans if the Company has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

(ii) Deferred profit sharing plan ("DPSP")

The Company has a DPSP under which the Company pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. Obligations for contributions are recognized as an expense in income when they are due in respect of service rendered before the end of the reporting period.

(iii) Stock-based compensation

Stock option plan

The Company has a stock option plan for eligible employees. Under this plan, options are periodically awarded to participants to purchase common shares at prices equal to the closing market price of the shares or the volume-weighted average closing price of the Company's common shares on the TSX for the five consecutive trading days immediately prior to the date the options were granted. The Company uses the fair value-based method of accounting for stock options and recognizes compensation expense based on the fair value of the options on the date of the grant, which is determined using the Black-Scholes option pricing model. The fair value of the options is recognized on a straight-line basis over the vesting period of the options granted as compensation expense with a corresponding increase in Contributed surplus. The awards are delivered in tranches; each tranche is considered a separate award and is valued and amortized separately. Expected forfeitures are factored into determining the stock option expense and the estimates are periodically adjusted in the event of actual forfeitures or for changes in expectations. The Contributed surplus balance is reduced as the options are exercised and the amount initially recorded for the options in Contributed surplus is reclassified to capital stock. Compensation expense related to the stock-based compensation plan is included in Non-interest expense – Compensation and benefits in the Consolidated Statements of Income.

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(\$ THOUSANDS, EXCEPT SHARE, PER SHARE AND STOCK OPTION AMOUNTS)

RSU plan

The Company has an RSU plan and may grant RSUs and/or Performance Share Units (“PSUs”) to eligible employees on an annual basis. The expense related to the award of these units is included in Non-interest expense – compensation and benefits in the Consolidated Statements of Income over the vesting period and any corresponding liability is included in Other liabilities in the Consolidated Balance Sheets. Since each RSU or PSU represents a notional common share, any changes in unit value and re-invested notional dividend amounts are recognized in the Consolidated Statements of Income. Each RSU or PSU held at the end of the vesting period including those acquired as dividend equivalents will be paid to the eligible employee in cash, the value of which will be based on the volume-weighted average closing price of the Company’s common shares on the TSX for the five consecutive trading days immediately prior to the vesting. The value of PSUs may be increased or decreased up to 25%, based on the Company’s relative total shareholder return compared to a defined peer group of financial institutions in Canada, and the incremental expense or recovery on those shares is recorded when the Company can reliably estimate the actual payout.

DSU plan

The Company has a DSU plan for Directors. The obligation that results from the award of a DSU is recognized in income upon the grant of the unit and the corresponding amount is included in Other liabilities in the Consolidated Balance Sheets. A Director will be credited with additional DSUs whenever a cash dividend is declared by the Company. The change in the obligation attributable to the change in stock price of Equitable Group Inc. and dividends paid on common shares is recognized in Non-interest expense – Compensation and benefits in the Consolidated Statements of Income for the period in which the changes occur. The redemption value of each DSU is the volume-weighted average trading price of the common shares of Equitable Group Inc. on the TSX for the five trading days immediately prior to the redemption date.

Employee stock purchase (“ESP”) plan

The Company has an ESP plan for eligible employees. Under this plan, employees have the option of directing a portion of their gross salary towards the purchase of the Company’s common shares. The Company matches a fixed portion of employee share purchases up to a specified maximum. Employer contributions are recognized in Non-interest expense – Compensation and benefits in the period incurred.

(i) Income taxes

Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognized in income except to the extent that it relates to items recognized directly in OCI or equity. Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

The Company follows the asset and liability method of accounting for income taxes. Under the asset and liability method, deferred tax assets and liabilities represent the amount of tax applicable to temporary differences between the carrying amounts of the assets and liabilities and their values for tax purposes. Deferred tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the years that include the date of enactment or substantive enactment.

Current tax assets and liabilities are offset if there is a legally enforceable right to offset current tax assets against current tax liabilities, usually in respect of income taxes levied by the same tax authority on the same taxable entity, and the Company intends to settle current tax liabilities and assets on a net basis or settle the tax assets and liabilities simultaneously.

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Deferred tax assets and liabilities are offset if the Company has a legally enforceable right to set off the deferred tax assets and liabilities related to income taxes levied by the same tax authority on either the same taxable entity; or different taxable entities, but the entities intend to settle current tax liabilities and assets on a net basis, or their tax assets and liabilities will be realized simultaneously for each future period in which these differences reverse.

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent it is no longer probable that the related tax benefit will be realized.

(j) Capital assets

Capital assets are carried at cost less accumulated depreciation. Depreciation is calculated using a declining balance method over the estimated useful lives of the assets at the following annual rates as this most closely reflects the pattern of consumption of the future economic benefits:

| Capital asset categories | Rate of depreciation |
|--|-----------------------------|
| Furniture, fixtures and office equipment | 10% to 20% |
| Computer hardware and software | 20% to 33% |

Leasehold improvements are depreciated on a straight-line basis over the lesser of the lease term and the estimated useful life of the asset.

Depreciation methods, useful lives and residual values are reassessed at each financial year end and adjusted appropriately.

(k) Intangible assets

Intangible assets are comprised of internally generated system and software development costs. An intangible asset is recognized only when its cost can be reliably measured and includes all directly attributable costs necessary to create the asset to be capable of operating in the manner intended by management. Research costs are expensed and eligible development costs are capitalized. Intangible assets are carried at cost less any accumulated amortization and accumulated impairment losses, if any, in the Consolidated Balance Sheets. The Company's intangible assets are amortized on a straight-line basis over their useful lives, ranging from 3 to 10 years. Amortization expenses are included in Non-interest expenses – other in the Consolidated Statements of Income.

Intangible assets, including those under development are assessed for indicators of impairment at each reporting period. If there's an indication that impairment exists, the Company performs an impairment test by comparing the carrying amount of the intangible asset to its recoverable amount. If the recoverable amount is less than its carrying amount, the carrying amount is written down to its recoverable amount and an impairment loss is recognized in the Consolidated Statements of Income.

(l) Deposits

Deposits are comprised of Guaranteed Investment Certificates ("GIC"), High Interest Savings Accounts ("HISA") and institutional deposit notes. Deposits, with the exception of those designated as at fair value through income, are recorded on the Consolidated Balance Sheets at amortized cost plus accrued interest, using the effective interest rate method. Deferred deposit agent commissions are accounted for as a component of deposits with the amortization of these commissions, with the exception of commissions relating to deposits designated as at fair value through income, which are expensed as incurred, and are calculated on an effective yield basis as a component of interest expense.

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(m) Obligations under repurchase agreements

Investments sold under repurchase agreements represent sales of Government of Canada guaranteed debt securities by the Company effected with a simultaneous agreement to purchase the assets back at a specified price on a specified future date, which is generally short term. Repurchase agreements are treated as borrowings and are carried at amortized cost, plus accrued interest, using the effective interest rate method, recorded in the Consolidated Balance Sheets at the respective prices at which the investments were originally sold plus accrued interest. Interest expense relating to repurchase agreements is recorded in Interest expense – Other in the Consolidated Statements of Income.

(n) Bank facilities and debentures

Bank facilities and debentures are recorded in the Consolidated Balance Sheets at amortized cost using the effective interest rate method.

(o) Share capital

Issuance costs

Incremental costs directly attributable to the issuance of an equity instrument are deducted from the initial measurement of the equity instruments and is presented net of tax.

(p) Earnings per share

Earnings per share is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding for the year. Net income available to common shareholders is determined by deducting the dividend entitlements of preferred shareholders from net income. Diluted earnings per share reflects the potential dilution that could occur if additional common shares are assumed to be issued under securities or contracts that entitle their holders to obtain common shares in the future. The number of additional shares for inclusion in diluted earnings per share calculations is determined using the treasury stock method. Under this method, stock options which exercise price is less than the average market price of the Company's common shares are assumed to be exercised and the proceeds are used to repurchase common shares at the average market price for the year. The incremental number of common shares issued under stock options and repurchased from proceeds is included in the calculation of diluted earnings per share.

(q) Interest

Interest income and interest expense are recognized in the Consolidated Statements of Income using the effective interest rate method and the rate is applied to the gross carrying amount of the asset (when the asset is not credit impaired) or to the amortized cost of the liability. The effective interest rate is the rate that exactly discounts the estimated future cash flow payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. When calculating the effective interest rate, management estimates future cash flows considering all contractual terms of the financial instrument, but not expected credit losses. Under IFRS 9, for financial assets that become credit-impaired subsequent to initial recognition, interest income is calculated by applying the effective interest rate to the amortized cost of the financial asset. If the asset is no longer credit-impaired, then the calculation of interest income reverts to the gross basis. The calculation of the effective interest rate includes all transaction costs and fees paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or financial liability.

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(r) Fees

Other income includes some ancillary fees related to the administration of the loan portfolio. These fees are measured based on the consideration specified in the agreements with customers and are accrued and recognized as the related services are rendered.

(s) Provisions

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money.

(t) Write-off

The Company writes off an impaired financial asset, either partially or in full, when there is no realistic prospect of recovery. Where financial assets are secured, write-off is after the expected proceeds from the realization of collateral. In subsequent periods, recoveries if any, against written off loans are credited to the provision for credit losses in the Consolidated Statements of Income.

Future accounting changes

Conceptual Framework for Financial Reporting

On March 29, 2018, the IASB issued its revised Conceptual Framework for Financial Reporting (“Framework”) that is effective from January 1, 2020 for the Company. The Framework itself is not a standard, and does not override existing standards. It is used by the IASB in developing and revising accounting standards based on consistent concepts.

The Company has evaluated the impact of the Framework and related amendments to the accounting standards, and concluded that the Framework will not have a material affect on the Company’s accounting policies.

Interbank Offered Rates (“IBOR”) reform

On September 26, 2019, the IASB published “Interest Rate Benchmark Reform: Amendments to IFRS 9, IAS 39 and IFRS 7” as a result of potential effects the IBOR reform could have on financial reporting. The amendments provide relief for financial instruments qualifying for hedge accounting which are affected during the period of uncertainty leading up to contractual rate replacement. The amendments require providing specific disclosures for the affected hedging relationships. The amendments are effective for annual periods beginning on or after January 1, 2020, with earlier application permitted.

The Company does not consider the impact of the IBOR reform to be material, as the Company only operates in the Canadian jurisdiction and a majority of its derivative contracts use Canadian Dollar Offered Rate (“CDOR”) as reference rates.

Note 4 – Risk Management

The Company, like other financial institutions, is exposed to the symptoms and effects of global economic conditions and other factors that could adversely affect its business, financial condition and operating results, which may also influence an investor to buy, sell or hold shares in the Company. Many of these risk factors are beyond the Company’s direct control. The use of financial instruments exposes the Company to credit risk, liquidity risk and market risk. A discussion of the Company’s risk exposures and how it manages those risks can be found in the Risk Management section of the Company’s MD&A on pages 50-65.

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Note 5 – Business Combination

On January 1, 2019, the Company acquired 100% ownership in Bennington Financial Corp. (“Bennington”), a privately owned company serving the brokered equipment leasing market in Canada. Bennington was founded in Oakville, Ontario in 1996 and finances a wide range of assets with a focus on transportation, construction, and food service equipment, and has long-tenured relationships with professional leasing brokers throughout Canada. The Company’s acquisition of Bennington diversifies it into an adjacent market and complements its other secured lending businesses and broker-led distribution model.

The Company initially paid \$47,065 in an all cash transaction and recognized goodwill of \$11,258. During the year, the Company finalized the purchase consideration to \$46,722 and also finalized the purchase price allocation, resulting in an increase in goodwill by \$5,686. The following table presents the estimated fair values of the assets and liabilities acquired as of the date of acquisition.

| | January 1, 2019 |
|--|-----------------|
| Assets: | |
| Restricted cash | \$ 42,578 |
| Loans – Commercial: Finance leases | 429,743 |
| Capital and intangible assets | 9,412 |
| Other assets | 5,761 |
| | 487,494 |
| Liabilities: | |
| Securitization liabilities | 388,147 |
| Deferred tax liabilities | 13,802 |
| Bank facilities | 31,083 |
| Accounts payable and accrued liabilities | 24,634 |
| | 457,666 |
| Fair value of identifiable net assets acquired | 29,828 |
| Goodwill | 16,944 |
| Total purchase consideration | \$ 46,772 |

Note 6 – Financial Instruments

The Company’s business activities result in a Consolidated Balance Sheets that consist primarily of financial instruments. The majority of the Company’s net income is derived from gains, losses, income and expenses related to these financial assets and liabilities.

(a) Valuation methods and assumptions

Valuation methods and assumptions used to estimate fair values of financial instruments are as follows:

(i) Financial instruments whose cost or amortized cost approximates fair value

The fair value of Cash and cash equivalents and Restricted cash approximate their cost due to their short term nature.

Securities purchased under reverse repurchase agreements, obligations under repurchase agreements, bank facilities and certain other financial assets and liabilities are carried at cost or amortized cost, which approximates fair value.

(ii) Financial instruments classified as at FVOCI and FVTPL

These financial assets and financial liabilities are measured on the Consolidated Balance Sheets at fair value. For financial instruments measured at fair value where active market prices are available, bid prices are used for financial

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(\$ THOUSANDS, EXCEPT SHARE, PER SHARE AND STOCK OPTION AMOUNTS)

assets and ask prices for financial liabilities. For those financial instruments measured at fair value that are not traded in an active market, fair value estimates are determined using valuation methods which maximize the use of observable market data and include discounted cash flow analysis and other commonly used valuation techniques.

(iii) Loans receivable

The estimated fair value of loans receivable is determined using a discounted cash flow calculation and the market interest rates offered for loans with similar terms and credit risks.

(iv) Deposits

The estimated fair value of deposits is determined by discounting expected future contractual cash flows using observed market interest rates offered for deposits with similar terms. Deposit liabilities include GICs that are measured at fair value through income and are guaranteed by Canada Deposit Insurance Corporation ("CDIC"). This guarantee from CDIC is reflected in the fair value measurement of the deposit liabilities.

(v) Securitization liabilities

The estimated fair value of securitization liabilities is determined by discounting expected future contractual cash flows using market interest rates offered for similar terms.

(vi) Derivatives

Fair value estimates of derivative financial instruments are determined based on commonly used pricing methodologies (primarily discounted cash flow models) that incorporate observable market data. Frequently applied valuation techniques incorporate various inputs such as stock prices, bond prices, and interest rate curves into present value calculations.

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The following tables present the carrying values for each category of financial assets and liabilities and their estimated fair values as at December 31, 2019 and December 31, 2018. The tables do not include assets and liabilities that are not financial instruments.

| | December 31, 2019 | | | | | |
|--|------------------------|--------------------------------|----------------------------------|----------------------|----------------------------|----------------------|
| | FVTPL – Mandatorily | FVOCI – Debt instruments | FVOCI – Equity instruments | Amortized cost | Total carrying value | Fair value |
| Financial assets: | | | | | | |
| Cash and cash equivalents | \$ - | \$ - | \$ - | \$ 508,853 | \$ 508,853 | \$ 508,853 |
| Restricted cash | - | - | - | 462,992 | 462,992 | 462,992 |
| Securities purchased under reverse repurchase agreements | - | - | - | 150,069 | 150,069 | 150,069 |
| Investments | 55,533 | 43,199 | 92,386 | 171,493 | 362,611 | 361,134 |
| Loans – Retail ⁽¹⁾ | - | - | - | 18,359,805 | 18,359,805 | 18,331,260 |
| Loans – Commercial ⁽¹⁾⁽²⁾ | 195,051 | - | - | 7,566,364 | 7,761,415 | 7,771,496 |
| Securitization retained interests | - | - | - | 139,009 | 139,009 | 139,336 |
| Other assets: | | | | | | |
| Derivative financial instruments ⁽³⁾ : | | | | | | |
| Interest rate swaps | 14,468 | - | - | - | 14,468 | 14,468 |
| Total return swaps | 6,686 | - | - | - | 6,686 | 6,686 |
| Bond forwards | 1,939 | - | - | - | 1,939 | 1,939 |
| Other | - | - | - | 19,139 | 19,139 | 19,139 |
| Total financial assets | \$ 273,677 | \$ 43,199 | \$ 92,386 | \$ 27,377,724 | \$ 27,786,986 | \$ 27,767,372 |
| Financial liabilities: | | | | | | |
| Deposits | \$ - | \$ - | \$ - | \$ 15,442,207 | \$ 15,442,207 | \$ 15,451,289 |
| Securitization liabilities | - | - | - | 10,706,956 | 10,706,956 | 10,719,070 |
| Obligations under repurchase agreements | - | - | - | 507,044 | 507,044 | 507,044 |
| Other liabilities: | | | | | | |
| Derivative financial instruments ⁽³⁾ : | | | | | | |
| Interest rate swaps | 4,959 | - | - | - | 4,959 | 4,959 |
| Total return swaps | 7,083 | - | - | - | 7,083 | 7,083 |
| Loan commitments | 209 | - | - | - | 209 | 209 |
| Other | - | - | - | 179,740 | 179,740 | 179,740 |
| Total financial liabilities | \$ 12,251 | \$ - | \$ - | \$ 26,835,947 | \$ 26,848,198 | \$ 26,869,394 |

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| | December 31, 2018 | | | | | |
|--|------------------------|--------------------------------|----------------------------------|----------------------|----------------------------|----------------------|
| | FVTPL – Mandatorily | FVOCI – Debt instruments | FVOCI – Equity instruments | Amortized cost | Total carrying value | Fair value |
| Financial assets: | | | | | | |
| Cash and cash equivalents | \$ - | \$ - | \$ - | \$ 477,243 | \$ 477,243 | \$ 477,243 |
| Restricted cash | - | - | - | 327,097 | 327,097 | 327,097 |
| Securities purchased under reverse repurchase agreements | - | - | - | 250,000 | 250,000 | 250,000 |
| Investments | 30,823 | 58,311 | 100,607 | 3,658 | 193,399 | 193,399 |
| Loans – Retail ⁽¹⁾ | - | - | - | 16,203,138 | 16,203,138 | 16,141,054 |
| Loans – Commercial ⁽¹⁾⁽²⁾ | 243,854 | - | - | 7,079,412 | 7,323,266 | 7,311,118 |
| Securitization retained interests | - | - | - | 115,331 | 115,331 | 115,048 |
| Other assets: | | | | | | |
| Derivative financial instruments ⁽³⁾ : | | | | | | |
| Interest rate swaps | 16,315 | - | - | - | 16,315 | 16,315 |
| Total return swaps | 1,704 | - | - | - | 1,704 | 1,704 |
| Loan commitments | 55 | - | - | - | 55 | 55 |
| Other | - | - | - | 12,983 | 12,983 | 12,983 |
| Total financial assets | \$ 292,751 | \$ 58,311 | \$ 100,607 | \$ 24,468,862 | \$ 24,920,531 | \$ 24,846,016 |
| Financial liabilities: | | | | | | |
| Deposits | \$ - | \$ - | \$ - | \$ 13,668,521 | \$ 13,668,521 | \$ 13,653,490 |
| Securitization liabilities | - | - | - | 9,236,045 | 9,236,045 | 9,218,609 |
| Obligations under repurchase agreements | - | - | - | 342,010 | 342,010 | 342,010 |
| Bank facilities | - | - | - | 289,971 | 289,971 | 289,971 |
| Other liabilities: | | | | | | |
| Derivative financial instruments ⁽³⁾ : | | | | | | |
| Interest rate swaps | 7,265 | - | - | - | 7,265 | 7,265 |
| Total return swaps | 3,707 | - | - | - | 3,707 | 3,707 |
| Bond forwards | 2,331 | - | - | - | 2,331 | 2,331 |
| Other | - | - | - | 164,451 | 164,451 | 164,451 |
| Total financial liabilities | \$ 13,303 | \$ - | \$ - | \$ 23,700,998 | \$ 23,714,301 | \$ 23,681,834 |

⁽¹⁾ Effective January 1, 2019, the Company has changed the presentation of its loan products (refer to Note 2 (f)). Prior year presentation has been updated accordingly.

⁽²⁾ Loans – Commercial does not include \$486,610 (December 31, 2018 - \$nil) of Finance leases, as these are specifically excluded for classification and measurement under IFRS 9.

⁽³⁾ Derivative financial instruments are non-trading, and include derivatives held in hedge accounting relationships.

(b) Fair value hierarchy

Financial instruments recorded at fair value on the Consolidated Balance Sheets are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements.

The fair value hierarchy has the following levels:

Level 1: valuation based on quoted prices (unadjusted) observed in active markets for identical assets and liabilities.

Level 2: valuation techniques based on inputs other than quoted prices included in Level 1 that are either directly or indirectly observable for the asset or liability.

Level 3: valuation techniques with significant unobservable market inputs.

The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. The objective of valuation techniques is to arrive at a fair value determination that reflects the price of the financial instrument at the reporting date

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that would have been determined by market participants acting at arm's length. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value.

The following table presents the fair value hierarchy of all financial instruments, whether or not measured at fair value in the Consolidated Balance Sheets, except for certain financial instruments whose carrying amount always approximates their fair values due to their short-term nature:

| | December 31, 2019 | | | |
|---|-------------------|----------------------|----------------------|---|
| | Level 1 | Level 2 | Level 3 | Total financial assets/ financial liabilities at fair value |
| Financial assets: | | | | |
| Investments | \$ 353,973 | \$ - | \$ 7,161 | \$ 361,134 |
| Loans – Retail ⁽¹⁾ | - | - | 18,331,260 | 18,331,260 |
| Loans – Commercial ⁽¹⁾ | - | 195,051 | 7,576,445 | 7,771,496 |
| Securitization retained interests | - | 139,336 | - | 139,336 |
| Other assets: | | | | |
| Derivative financial instruments ⁽²⁾ : | | | | |
| Interest rate swaps | - | 14,468 | - | 14,468 |
| Total return swaps | - | 6,242 | 444 | 6,686 |
| Bond forwards | - | 1,939 | - | 1,939 |
| Other | - | 19,139 | - | 19,139 |
| Total financial assets | \$ 353,973 | \$ 376,175 | \$ 25,915,310 | \$ 26,645,458 |
| Financial liabilities: | | | | |
| Deposits | \$ - | \$ 15,451,289 | \$ - | \$ 15,451,289 |
| Securitization liabilities | - | 9,809,562 | 909,508 | 10,719,070 |
| Other liabilities: | | | | |
| Derivative financial instruments ⁽²⁾ : | | | | |
| Interest rate swaps | - | 4,959 | - | 4,959 |
| Total return swaps | - | 12 | 7,071 | 7,083 |
| Loan commitments | - | - | 209 | 209 |
| Other | - | 179,740 | - | 179,740 |
| Total financial liabilities | \$ - | \$ 25,445,562 | \$ 916,788 | \$ 26,362,350 |

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| | December 31, 2018 | | | |
|---|-------------------|----------------------|----------------------|---|
| | Level 1 | Level 2 | Level 3 | Total financial assets/ financial liabilities at fair value |
| Financial assets: | | | | |
| Investments | \$ 182,015 | \$ 2,315 | \$ 9,069 | \$ 193,399 |
| Loans – Retail ⁽¹⁾ | - | - | 16,141,054 | 16,141,054 |
| Loans – Commercial ⁽¹⁾ | - | 243,854 | 7,067,264 | 7,311,118 |
| Securitization retained interests | - | 115,048 | - | 115,048 |
| Other assets: | | | | |
| Derivative financial instruments ⁽²⁾ : | | | | |
| Interest rate swaps | - | 16,315 | - | 16,315 |
| Total return swaps | - | 350 | 1,354 | 1,704 |
| Loan commitments | - | - | 55 | 55 |
| Other | - | 12,983 | - | 12,983 |
| Total financial assets | \$ 182,015 | \$ 390,865 | \$ 23,218,796 | \$ 23,791,676 |
| Financial liabilities: | | | | |
| Deposits | \$ - | \$ 13,653,490 | \$ - | \$ 13,653,490 |
| Securitization liabilities | - | 8,409,095 | 809,514 | 9,218,609 |
| Other liabilities: | | | | |
| Derivative financial instruments ⁽²⁾ : | | | | |
| Interest rate swaps | - | 7,265 | - | 7,265 |
| Total return swaps | - | 99 | 3,608 | 3,707 |
| Bond forwards | - | 2,331 | - | 2,331 |
| Other | - | 164,451 | - | 164,451 |
| Total financial liabilities | \$ - | \$ 22,236,731 | \$ 813,122 | \$ 23,049,853 |

⁽¹⁾ Effective January 1, 2019, the Company has changed the presentation of its loan products (refer Note 2 (f)). Prior period numbers have been updated accordingly.

⁽²⁾ Derivative financial instruments are non-trading, and include derivatives held in hedge accounting relationships.

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Note 7 – Cash and Cash Equivalents and Restricted Cash

| | December 31, 2019 | December 31, 2018 |
|--|-------------------|-------------------|
| Deposits with regulated financial institutions | \$ 508,853 | \$ 477,243 |
| Cash and cash equivalents | \$ 508,853 | \$ 477,243 |
| Restricted cash – securitization | \$ 454,553 | \$ 320,234 |
| Restricted cash – interest rate swaps | 7,826 | 6,355 |
| Restricted cash – other programs | 613 | 508 |
| Restricted cash | \$ 462,992 | \$ 327,097 |

Restricted cash – securitization represents deposits held in trust in connection with the Company's securitization activities. These deposits include cash accounts held at a major Schedule I Canadian Bank that hold principal and interest payments collected from securitized loans awaiting payment to their respective investors, deposits held as collateral by third parties for the Company's securitization hedging activities and deposits held in interest reinvestment accounts in connection with the Company's participation in the CMB program.

Restricted cash – interest rate swaps represent deposits held as collateral by third parties for the Company's interest rate swap transactions. The terms and conditions of these arrangements with counterparties are governed by the International Swaps and Derivatives Association, Inc. ("ISDA") agreements.

Restricted cash – other programs represent deposits held as collateral in connection with our Home Equity line of credit and deposit programs. These balances may be drawn upon only in the event of insufficient cash flows from the underlying programs.

Note 8 – Securities Purchased Under Reverse Repurchase Agreements

As at December 31, 2019, the fair value of financial assets accepted as collateral that the Company is permitted to sell or repledge in the absence of default is \$147,741 (December 31, 2018 – \$249,133). The Company is obliged to return equivalent securities at the repurchase date, and the Company did not sell or repledge any of the collateral as at the year ended December 31, 2019.

Note 9 – Investments

Carrying value of investments is as follows:

| | December 31, 2019 | December 31, 2018 |
|--------------------------------------|-------------------|-------------------|
| Equity securities measured at FVOCI | \$ 92,386 | \$ 100,607 |
| Equity securities measured at FVTPL | 1,100 | 292 |
| Debt securities measured as at FVOCI | 43,200 | 58,311 |
| Debt securities measured at FVTPL | 54,432 | 30,531 |
| Debt securities measured at AMC | 171,493 | 3,658 |
| | \$ 362,611 | \$ 193,399 |

The Company has elected to designate certain Equity securities to be measured at FVOCI as these investments are expected to be held for the long term. For the year ended December 31, 2019, the Company earned dividends of \$5,388 (2018 – \$4,671) on these Equity securities. During the year, the Company sold Equity securities of \$5,829 (2018 – \$238) and recognized a net loss of \$638 (2018 – \$9) in Retained earnings.

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Net unrealized gains (losses) on investments measured as at FVOCI and FVTPL are as follows:

| | 2019 | 2018 |
|-------------------------------------|------------|-------------|
| Equity securities measured at FVOCI | \$ (1,958) | \$ (14,495) |
| Equity securities measured at FVTPL | (280) | (8) |
| Debt securities measured at FVOCI | 239 | 55 |
| Debt securities measured at FVTPL | (1,444) | (3,855) |

Note 10 – Loans Receivable

(a) Loans receivable

| | December 31, 2019 | | | | | | |
|--------------------|----------------------|-----------------------------|------------------|-----------------|------------------|----------------------|------------|
| | Gross amount | Allowance for credit losses | | | | Total | Net amount |
| | | Stage 1 | Stage 2 | Stage 3 | | | |
| Loans – Retail | \$ 18,367,715 | \$ 3,295 | \$ 2,417 | \$ 2,198 | \$ 7,910 | \$ 18,359,805 | |
| Loans – Commercial | 8,277,022 | 16,758 | 9,375 | 2,864 | 28,997 | 8,248,025 | |
| | \$ 26,644,737 | \$ 20,053 | \$ 11,792 | \$ 5,062 | \$ 36,907 | \$ 26,607,830 | |

| | December 31, 2018 | | | | | | |
|--------------------|----------------------|-----------------------------|-----------------|-----------------|------------------|----------------------|------------|
| | Gross amount | Allowance for credit losses | | | | Total | Net amount |
| | | Stage 1 | Stage 2 | Stage 3 | | | |
| Loans – Retail | \$ 16,208,928 | \$ 2,068 | \$ 2,210 | \$ 1,513 | \$ 5,791 | \$ 16,203,137 | |
| Loans – Commercial | 7,342,774 | 12,528 | 6,966 | 13 | 19,507 | 7,323,267 | |
| | \$ 23,551,702 | \$ 14,596 | \$ 9,176 | \$ 1,526 | \$ 25,298 | \$ 23,526,404 | |

Loans – Commercial include certain loans measured as at FVTPL with changes in fair value included in gains on securitization activities and income from securitization retained interests. As at December 31, 2019, the carrying value of these loans was \$96,779 (December 31, 2018 – \$122,456) and included fair value adjustment of (\$726) (December 31, 2018 – \$1,027).

Loans – Commercial also include certain loans measured as at FVTPL with changes in fair value included in Interest income – Commercial. As at December 31, 2019, the carrying amount of these loans was \$98,272 (December 31, 2018 – \$121,398) and included fair value adjustment of \$424 (December 31, 2018 – \$774).

The impact of changes in fair value for loans measured as at fair value through income is as follows:

| | 2019 | 2018 |
|---|------------|----------|
| Net (losses) gains in fair values for loans measured as at FVTPL included in gains on securitization activities | \$ (1,753) | \$ 1,430 |
| Net gains (losses) in fair values for loans measured as at FVTPL and recognized in Interest income – Commercial | 1,179 | (1,344) |

Loans – Commercial include loans of \$169,859 (December 31, 2018 – \$181,404) invested in certain asset-backed structured entities. The Company holds a senior position in these investments and the maximum exposure to loss is limited to the carrying value of the investment. The Company does not have the ability to direct the relevant activities of these structured entities and has no exposure to their variable returns, other than the right to receive interest income from these investments. Consequently, the Company does not control these structured entities and has not consolidated them.

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Loans – Commercial also include the Company’s net investment in finance leases of \$486,610 (December 31, 2018 – \$nil). The following table shows the maturity analysis of undiscounted minimum lease payments reconciled to the net investment in finance leases:

| | December 31, 2019 |
|--|-------------------|
| Minimum lease payments: | |
| Less than 1 year | \$ 231,813 |
| 1 year to less than 2 years | 171,253 |
| 2 years to less than 3 years | 101,427 |
| 3 years to less than 4 years | 42,405 |
| 4 years to less than 5 years | 11,338 |
| More than 5 years | 560 |
| Non performing leases – net | 16,320 |
| Total undiscounted lease payments receivable | 575,116 |
| Less: | |
| Security deposits held | (7,874) |
| Unearned finance income | (71,186) |
| Allowance for credit losses | (9,446) |
| Net investment in finance leases | \$ 486,610 |

For the year ended December 31, 2019, the Company earned finance income of \$53,095 (December 31, 2018 – \$nil) from its investment in finance leases. As at December 31, 2019, all of the Company’s leases are fixed rate leases with terms ranging from one to seven years, and approximately 82.2% of the Company’s finance leases were concentrated in the following five industry segments:

| | December 31, 2019 |
|-----------------------------|-------------------|
| Transportation – Long Haul | 40.5% |
| Transportation – Vocational | 16.5% |
| Food | 13.0% |
| Construction | 8.8% |
| Agriculture | 3.4% |

(b) Impaired and past due loans

Outstanding impaired loans, net of specific allowances are as follows:

| | December 31, 2019 | | | December 31, 2018 |
|---|-------------------|-----------------------------------|------------|-------------------|
| | Gross | Allowance for credit losses | Net | Net |
| Loans – Retail | \$ 51,061 | \$ 2,198 | \$ 48,863 | \$ 36,956 |
| Loans – Commercial – Conventional and Insured | 45,451 | 155 | 45,296 | 449 |
| Loans – Commercial – Finance Leases | 25,942 | 2,709 | 23,233 | - |
| | \$ 122,454 | \$ 5,062 | \$ 117,392 | \$ 37,405 |

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Years ended December 31, 2019 and 2018

(\$ THOUSANDS, EXCEPT SHARE, PER SHARE AND STOCK OPTION AMOUNTS)

Outstanding loans that are past due but not classified as impaired are as follows:

| | December 31, 2019 | | | |
|---|-------------------|--------------|-----------------|-----------|
| | 30 – 59 days | 60 – 89 days | 90 days or more | Total |
| Loans – Retail | \$ 39,872 | \$ 16,207 | \$ - | \$ 56,079 |
| Loans – Commercial – Conventional and Insured | 8,922 | 2,760 | - | 11,682 |
| Loans – Commercial – Finance Leases | 16,690 | 6,213 | - | 22,903 |
| | \$ 65,484 | \$ 25,180 | \$ - | \$ 90,664 |

| | December 31, 2018 | | | |
|---|-------------------|--------------|-----------------|-----------|
| | 30 – 59 days | 60 – 89 days | 90 days or more | Total |
| Loans – Retail | \$ 38,454 | \$ 18,708 | \$ - | \$ 57,162 |
| Loans – Commercial – Conventional and Insured | 845 | 2,479 | - | 3,324 |
| Loans – Commercial – Finance Leases | - | - | - | - |
| | \$ 39,299 | \$ 21,187 | \$ - | \$ 60,486 |

(c) Allowance for credit losses

| | December 31, 2019 | | | |
|---------------------------------------|-------------------|------------------------------|--------------------------|-----------|
| | 12 months ECL | Lifetime non-credit impaired | Lifetime credit impaired | Total |
| | Stage 1 | Stage 2 | Stage 3 | Total |
| Balance, beginning of year | \$ 14,596 | \$ 9,176 | \$ 1,526 | \$ 25,298 |
| Provision for credit losses: | | | | |
| Transfers to (from) Stage 1 | 1,377 | (659) | (718) | - |
| Transfers to (from) Stage 2 | (876) | 1,070 | (194) | - |
| Transfers to (from) Stage 3 | (5) | (22) | 27 | - |
| Re-measurement ⁽¹⁾ | (837) | (210) | 3,462 | 2,415 |
| Originations | 1,870 | - | - | 1,870 |
| Discharges | (272) | (100) | - | (372) |
| Finance Lease acquired ⁽²⁾ | 4,200 | 2,537 | 7,744 | 14,481 |
| Write-off | - | - | (5,035) | (5,035) |
| Realized losses | - | - | (2,155) | (2,155) |
| Recoveries | - | - | 405 | 405 |
| Balance, end of year ⁽³⁾ | \$ 20,053 | \$ 11,792 | \$ 5,062 | \$ 36,907 |

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| | December 31, 2018 | | | | |
|---|-------------------|-----------------|------------------------------------|--------------------------------|-------|
| | 12 months ECL | | Lifetime non-credit impaired | Lifetime credit impaired | Total |
| | Stage 1 | Stage 2 | Stage 3 | | |
| Balance, beginning of year | \$ 13,930 | \$ 9,627 | \$ 1,327 | \$ 24,884 | |
| Provision for credit losses: | | | | | |
| Transfers to (from) Stage 1 | 1,417 | (1,203) | (214) | - | |
| Transfers to (from) Stage 2 | (917) | 1,022 | (105) | - | |
| Transfers to (from) Stage 3 | (2) | (10) | 12 | - | |
| Re-measurement ⁽¹⁾ | (1,221) | (110) | 2,175 | 844 | |
| Originations | 1,509 | - | - | 1,509 | |
| Discharges | (120) | (150) | - | (270) | |
| Realized losses | - | - | (1,810) | (1,810) | |
| Recoveries | - | - | 141 | 141 | |
| Balance, end of year⁽³⁾ | \$ 14,596 | \$ 9,176 | \$ 1,526 | \$ 25,298 | |

⁽¹⁾ Includes movement as a result of significant increase or decrease in credit risk and changes in credit risk due to model inputs/assumptions that did not result in a transfer between stages

⁽²⁾ Finance lease acquired include \$5,749 of day one stage 1 allowance recognized on acquisition.

⁽³⁾ The allowance for credit losses includes allowance on loan commitments amounting to \$131 (December 31, 2018 - \$140).

(d) Key inputs, assumptions and model techniques

The Company's allowance for credit losses is estimated using statistical models that involve a large number of inputs and assumptions. The key drivers of changes in ECL include the following:

- Transfers between stages, due to significant changes in credit risk;
- Changes in forward looking macroeconomic conditions, specifically the macroeconomic variables to which the ECL models are calibrated, which are closely correlated with the credit losses in the relevant portfolios; and
- Changes to the probability weights assigned to each scenario.

In addition, these elements are also subject to a high degree of judgment which could have a significant impact on the level of ACL recognized.

(e) Forward-looking macroeconomic scenarios

The Company leverages forward-looking macroeconomic information provided by an external party. The Company considers five economic scenarios: a base-case scenario, one upside and three downside scenarios. Each scenario is assigned a probability weighting, with the base-case scenario receiving the highest weight. The probability-weighted scenarios are incorporated into both measurement of ECL and assessment of whether the credit risk of an instrument has increased significantly since its initial recognition.

The following table provides the primary macroeconomic variables used in models to estimate ECL on performing loans:

| | December 31, 2019 | | | | | | | | | |
|---|--------------------|--------------|-----------------|--------------|--------------------|--------------|----------------|--------------|----------------|--------------|
| | Base-Case Scenario | | Upside Scenario | | Downside Scenarios | | | | | |
| | | | | | Scenario 1 | | Scenario 2 | | Scenario 3 | |
| | Next 12 months | 2 to 5 years | Next 12 months | 2 to 5 years | Next 12 months | 2 to 5 years | Next 12 months | 2 to 5 years | Next 12 months | 2 to 5 years |
| Unemployment rate % | 5.75 | 6.11 | 5.42 | 5.58 | 5.93 | 6.76 | 6.93 | 7.86 | 7.03 | 9.08 |
| Real GDP growth rate % | 2.17 | 1.61 | 2.79 | 2.08 | 1.58 | 0.95 | (0.59) | 1.20 | (1.14) | 0.28 |
| Home Price Index growth rate % | 0.37 | 1.27 | 0.93 | 1.74 | (0.43) | 0.91 | (2.21) | 0.27 | (3.31) | (1.16) |
| Commercial Property Index growth rate % | 1.37 | 1.36 | 3.29 | 2.03 | 1.13 | 0.67 | (1.94) | 0.61 | (3.05) | (0.94) |
| Household income growth rate % | 0.00 | 0.08 | 0.04 | 0.91 | (0.42) | (0.62) | (1.20) | (1.19) | (1.10) | (2.56) |

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| | December 31, 2018 | | | | | | | | | |
|---|--------------------|--------------|----------------|--------------|--------------------|--------------|----------------|--------------|----------------|--------------|
| | Base-Case Scenario | | | | Downside Scenarios | | | | | |
| | Upside Scenario | | Scenario 1 | | Scenario 2 | | Scenario 3 | | | |
| | Next 12 months | 2 to 5 years | Next 12 months | 2 to 5 years | Next 12 months | 2 to 5 years | Next 12 months | 2 to 5 years | Next 12 months | 2 to 5 years |
| Unemployment rate % | 5.92 | 6.13 | 5.68 | 5.58 | 5.95 | 6.38 | 6.57 | 7.90 | 6.62 | 9.09 |
| Real GDP growth rate % | 2.06 | 2.04 | 2.15 | 2.74 | 1.56 | 1.76 | 0.13 | 1.54 | (0.43) | 0.50 |
| Home Price Index growth rate % | 1.98 | 1.29 | 2.33 | 1.55 | 1.43 | 1.14 | 0.65 | 1.13 | (0.28) | 0.89 |
| Commercial Property Index growth rate % | 2.80 | 1.64 | 4.28 | 2.21 | 2.70 | 1.10 | 0.50 | 0.80 | (0.57) | (0.17) |
| Household income growth rate % | 0.12 | 0.18 | 0.47 | 0.45 | 0.05 | 0.00 | (0.54) | (0.39) | (0.58) | (1.04) |

(f) Sensitivity of allowance for credit losses

The ECL is sensitive to the inputs used in internally developed models, macroeconomic variables in the forward-looking forecasts, the probability weightings of our five scenarios, and other factors considered when applying expert credit judgment. Changes in these inputs, assumptions, models, and judgments would have an impact on the assessment of credit risk and the measurement of ECLs.

Impact of probability-weighting on ACL

The following table presents a comparison of the Company's ACL using only the base-case scenario and downside scenario instead of the five probability-weighted scenarios for performing loans:

| | December 31, 2019 | December 31, 2018 |
|---|-------------------|-------------------|
| ACL – Five probability-weighted scenarios (actual) | \$ 31,845 | \$ 23,772 |
| ACL – Base-case scenario only | 30,202 | 23,126 |
| ACL – Downside scenario 3 only | 43,935 | 29,320 |
| Difference – Actual versus base-case scenario only | 1,643 | 646 |
| Difference – Actual versus downside scenario 3 only | \$ (12,090) | \$ (5,548) |

Impact of staging on ACL

The following table illustrates the impact of staging on the Company's ACL by comparing the allowance if all performing loans were in Stage 1 to the actual ACL recorded:

| | December 31, 2019 | December 31, 2018 |
|---|-------------------|-------------------|
| ACL – Loans in Stage 1 and Stage 2 (actual) | \$ 31,845 | \$ 23,772 |
| ACL – Assuming all loans in Stage 1 | 29,625 | 23,389 |
| Lifetime ACL impact | \$ 2,220 | \$ 383 |

Note 11 – Derecognition of Financial Assets

In the normal course of business, the Company enters into transactions that result in the transfer of financial assets. Transferred financial assets are recognized in their entirety or derecognized in their entirety, subject to the extent of the Company's continuing involvement. The Company transfers its financial assets through sale and repurchase agreements and its securitization activities.

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(a) Transferred financial assets that are not derecognized in their entirety

Obligations under repurchase agreements

Obligations under repurchase agreements are transactions in which the Company sells a security and simultaneously agrees to repurchase it at a fixed price on a future date. The Company continues to recognize the securities in their entirety on the Consolidated Balance Sheets because it retains substantially all the risks and rewards of ownership. The cash consideration received is recognized as a financial asset and the obligation to pay the repurchase price is recognized as a financial liability.

Securitizations

The Company securitizes insured residential loans by selling its issued MBS to third party investors including to the CMHC sponsored trust (Canada Housing Trust –“CHT”) under the CMB program. The Company may also retain certain issued MBS as part of its liquidity management strategy, as well as to manage interest rate risk associated with the Company’s participation in the CMB program. The CHT periodically issues CMB, which are guaranteed by the government, and sells them to third party investors. Proceeds from the CMB issuances are used by the CHT to purchase MBS from eligible MBS issuers who participate in the issuance of a particular CMB series.

Most of these securitization transactions do not qualify for derecognition as the Company continues to be exposed to substantially all of the risks and rewards associated with the transferred assets or it neither transfers nor retains substantially all the risks and rewards and retains control in the asset. A key risk associated with transferred loans to which the Company remains exposed after the transfer in such securitization transactions is the prepayment risk. As a result, the loans continue to be recognized on the Consolidated Balance Sheets at amortized cost and are accounted for as secured financing transactions, with the loans transferred pledged as collateral for these securitization liabilities.

The Company’s securitization activities include selling uninsured loans by entering into an agreement with another Schedule I bank and participating in a securitization program sponsored by that bank. Under this agreement, the Company sells the loans to the program and they remain in the program until maturity. The bank that sponsors the securitization program retains all of the refinancing risks related to the program. The sale of these loans does not qualify for derecognition as the Company continues to be exposed to substantially all of the risks and rewards associated with the transferred assets. As a result, the loans continue to be recognized on the Consolidated Balance Sheets at amortized cost and the proceeds received are recognized under securitization liabilities. The loans transferred are pledged as collateral for these securitization liabilities.

i) MBS securitizations

For MBS securitization liabilities, principal payments collected from the underlying loans are passed on to the MBS investors, reducing the amount of the liability outstanding on a monthly basis. Interest on the MBS securitization liability is calculated at the MBS coupon rate and is paid monthly to the MBS investors.

ii) CMB securitizations

As part of a CMB transaction, the Company may enter into total return swaps with highly rated counterparties, exchanging the cash flows of the CMB for those of the MBS transferred to CHT. Any excess or shortfall in these cash flows is absorbed by the Company. For transactions that fail derecognition, these swaps are not recognized on the Company’s Consolidated Balance Sheets as the underlying cash flows of these derivatives are captured through the continued recognition of the loans and their associated CMB securitization liabilities. Accordingly, these swaps are recognized on an accrual basis and are not fair valued through the Company’s Consolidated Statements of Income. As at December 31, 2019, the notional amount of these swaps was \$2,131,905 (December 31, 2018 – \$1,680,338).

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CMB securitization liabilities are non-amortizing bond liabilities with fixed maturity dates. Principal payments collected from the loans underlying the MBS sold to CHT are transferred to CHT on a monthly basis where they are held and invested in eligible investments until the maturity of the bond. To the extent that these eligible investments are not the Company's own issued MBS, the investments are recorded on the Company's Consolidated Balance Sheets under Investments – Canada Housing Trust re-investment accounts. Interest on the CMB securitization liabilities is calculated at the CMB coupon rate and is paid to the CMB holders on a monthly, quarterly, or semi-annual basis.

iii) Finance lease securitizations

The Company also securitizes pools of finance leased assets on a fully serviced basis to independent third party investors. The Company continues to be exposed to substantially all of the risks and rewards associated with the transferred pools of leases and therefore does not derecognize the leased assets. The corresponding securitization liabilities are repaid on a monthly basis with financing rates ranging from 2.83% to 5.47%.

The following table provides information on the carrying amount and the fair values related to transferred financial assets that are not derecognized in their entirety and the associated liabilities:

| | 2019 | | 2018 | |
|---|--------------------|---|--------------------|---|
| | Securitized assets | Assets sold under repurchase agreements | Securitized assets | Assets sold under repurchase agreements |
| Carrying amount of assets | \$ 10,707,145 | \$ 507,044 | \$ 9,365,527 | \$ 342,010 |
| Carrying amount of associated liability | 10,706,956 | 507,044 | 9,236,045 | 342,010 |
| Carrying value, net position | \$ 189 | \$ - | \$ 129,482 | \$ - |
| Fair value of assets | \$ 10,703,277 | \$ 507,044 | \$ 9,315,515 | \$ 342,010 |
| Fair value of associated liability | 10,718,809 | 507,044 | 9,218,609 | 342,010 |
| Fair value, net position | \$ (15,532) | \$ - | \$ 96,906 | \$ - |

The carrying amount of assets include \$167,113 (December 31, 2018 – \$nil) of the Company's net investment in finance leases that were securitized and not derecognized. The carrying value of associated liability includes \$160,658 (December 31, 2018 – \$nil) of liabilities pertaining to finance leases securitized.

The Company estimates that the principal amount of securitization liabilities will be paid as follows:

| | MBS Liabilities | CMB Liabilities | Lease Securitization Liabilities | Other Securitization Liabilities | Total Liabilities |
|------------|-----------------|-----------------|----------------------------------|----------------------------------|-------------------|
| 2020 | \$ 1,433,369 | \$ 509,366 | \$ 85,612 | \$ 326,384 | \$ 2,354,731 |
| 2021 | 1,455,548 | 673,585 | 51,176 | 318,325 | 2,498,634 |
| 2022 | 767,699 | 457,616 | 18,977 | 68,032 | 1,312,324 |
| 2023 | 1,763,146 | 193,825 | 3,842 | 22,839 | 1,983,652 |
| 2024 | 1,309,458 | 454,917 | 31 | 13,349 | 1,777,755 |
| Thereafter | 744,446 | 81,585 | - | - | 826,031 |
| | \$ 7,473,666 | \$ 2,370,894 | \$ 159,638 | \$ 748,929 | \$ 10,753,127 |

(b) Transfers that are derecognized in their entirety

Certain securitization transactions undertaken by the Company result in the Company derecognizing the transferred assets in their entirety. This is the case where the Company has securitized and sold pools of residential loans with no prepayment option to third parties. The Company does not retain substantially all the risks and rewards of ownership and transfers control

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over the assets. The Company retains some continuing involvement in the transaction which is represented by the retained interests and the associated servicing liabilities.

The Company also achieves derecognition on the securitization and sale of certain pools of residential loans with a prepayment option. In these transactions, the Company securitizes and sells pools of residential loans and then engages in a transaction to transfer its rights in the excess interest spread and/or any prepayment risk, thereby transferring substantially all the risks and rewards of ownership in the asset and derecognizing the asset in its entirety. During the current and prior year the Company did not derecognize any multi-residential loans with a prepayment option.

The following table provides quantitative information of the Company's securitization activities and transfers that are derecognized in their entirety during the year:

| | 2019 | 2018 |
|--|------------|------------|
| Loans securitized and sold | \$ 891,723 | \$ 976,085 |
| Carrying value of Securitization retained interests | 55,413 | 38,815 |
| Carrying value of Securitized loan servicing liability | 8,340 | 8,462 |
| Gains on loans securitized and sold | 9,888 | 9,025 |
| Income from securitization activities and retained interests | 1,646 | 1,260 |

The expected undiscounted cash flows payable to the MBS holders on the Company's securitization activities and transfer that are derecognized in their entirety are as follows:

| | MBS Liabilities |
|------------|-----------------|
| 2020 | \$ 705,240 |
| 2021 | 594,498 |
| 2022 | 843,117 |
| 2023 | 857,643 |
| 2024 | 651,828 |
| Thereafter | 1,365,011 |
| | \$ 5,017,337 |

Note 12 – Derivative Financial Instruments

(a) Hedge instruments

Cash flow hedges

The Company's securitization activities are subject to interest rate risk, which represents the potential for changes in interest rates between the time the Company commits to funding a loan it intends to securitize through the issuance of a securitization liability, and the time the liability is actually issued. The Company utilizes derivative financial instruments in the form of bond forwards and interest rate swaps to hedge this exposure, with the intent to manage the change in cash flows of the future interest payments on the highly probable forecasted issuance of the securitization liability. The Company applies hedge accounting to these derivative financial instruments to minimize the volatility in income caused by changes in interest rates.

The Company also uses bond forwards to hedge changes in future cash flows from changes in interest rates attributable to highly probable forecasted issuance of fixed rate liabilities. The Company applies hedge accounting to these derivative financial instruments to minimize the volatility in income caused by changes in interest rates.

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The Company hedges the risk of changes in future cash flows related to its floating rate securitization liabilities by entering into interest rate swaps. The Company applies hedge accounting to these derivative financial instruments to minimize the volatility in income caused by changes in interest rates.

The Company also hedges the risk of changes in future cash flows related to its Restricted share unit plan by entering into total return equity swap contracts with third parties, the value of which is linked to the price of the Company's common shares. Changes in the fair value of these derivative financial instruments offset the compensation expense related to the change in share price, over the period in which the swap is in effect. The Company applies hedge accounting to these derivative financial instruments to minimize the volatility in income caused by changes in the Company's share price.

The Company also hedges the risk of changes in future cash flows related to its Deferred share unit plan by entering into a total return equity swap contract with a third party. The value of this derivative financial instrument is linked to the price of the Company's common shares. Changes in fair value of the derivative offsets the compensation expense related to the change in share price, over the period in which the swap is in effect. The Company does not apply hedge accounting to this derivative financial instrument.

Fair value hedges

The Company enters into hedging transactions to manage interest rate exposures on loan commitments and certain deposits used to fund floating rate loans. The hedging instruments used to manage these exposures are interest rate swaps and bond forwards. The Company does not apply hedge accounting to these hedging relationships.

The Company also enters into hedging transactions to manage interest rate exposure on certain loan assets, securitization liabilities, and deposit liabilities. Starting this year the Company entered into interest rate swap agreements to manage interest rate exposures on fixed rate loans. The Company applies hedge accounting to all these relationships.

(b) Other derivatives

Total return swaps

As part of its CMB activities, the Company may assume reinvestment risk between the amortizing MBS and the bullet CMB for securitized loans which are derecognized. The Company assumes this risk by entering into total return swaps with highly rated counterparties and exchanging the cash flows of the CMB for those of the MBS transferred to CHT. These swaps are recognized on the Company's consolidated balances sheets and fair valued through the Company's Consolidated Statements of Income.

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(c) Financial impact of derivatives

The fair values and notional amounts of derivatives outstanding is as follows:

| Derivative instrument and term (years) | December 31, 2019 | | | | | | | | |
|--|---------------------|------------------------------------|--|---|--------------------------------------|------------------|--------------------|-------------|--------------------|
| | Notional amount | Average Rate/ Price ⁽¹⁾ | Positive current replacement cost ⁽²⁾ | Credit equivalent amount ⁽³⁾ | Risk-weighted balance ⁽⁴⁾ | Fair value | | | Net ⁽⁵⁾ |
| | | | | | | Assets | Liabilities | | |
| Cash flow hedges: | | | | | | | | | |
| Bond forwards – hedge accounting | | | | | | | | | |
| 1 or less | \$ 86,900 | 1.81% | \$ 934 | \$ 1,477 | \$ 1,477 | \$ 934 | \$ - | \$ - | 934 |
| Interest rate swaps – hedge accounting | | | | | | | | | |
| 1 or less | 212,486 | 1.99% | 7 | 952 | 190 | 18 | - | - | 18 |
| 1 to 5 | 486,558 | 1.57% | 3,412 | 4,006 | 801 | 4,551 | - | - | 4,551 |
| Total return swaps – hedge accounting | | | | | | | | | |
| 1 or less | 2,287 | 56.29 | 117 | 10 | 2 | 2,254 | - | - | 2,254 |
| 1 to 5 | 5,775 | 88.96 | 96 | 26 | 5 | 1,889 | (12) | - | 1,877 |
| Total return swaps – non-hedge accounting | | | | | | | | | |
| 1 or less | 3,965 | N/A | 107 | 18 | 4 | 2,099 | - | - | 2,099 |
| Fair value hedges: | | | | | | | | | |
| Interest rate swaps – hedge accounting | | | | | | | | | |
| 1 to 5 | 1,108,900 | 1.93% | 747 | 5,660 | 1,132 | 3,855 | (3,436) | - | 419 |
| 5 and above | 57,621 | 1.92% | 71 | 493 | 99 | 971 | (11) | - | 960 |
| Interest rate swaps – non-hedge accounting | | | | | | | | | |
| 1 to 5 | 445,599 | N/A | 883 | 2,241 | 448 | 3,319 | (1,182) | - | 2,137 |
| 5 and above | 113,074 | N/A | 1,162 | 1,769 | 354 | 1,754 | (330) | - | 1,424 |
| Bond forwards – non-hedge accounting | | | | | | | | | |
| 1 or less | 80,525 | N/A | 1,005 | 1,368 | 1,368 | 1,005 | - | - | 1,005 |
| Other derivatives: | | | | | | | | | |
| Total return swaps | | | | | | | | | |
| 1 to 5 | 2,236,275 | N/A | 1,302 | 1,535 | 307 | 95 | (2,179) | - | (2,084) |
| 5 and above | 1,199,393 | N/A | 1,163 | 2,063 | 413 | 349 | (4,892) | - | (4,543) |
| | \$ 6,039,358 | | \$ 11,006 | \$ 21,618 | \$ 6,600 | \$ 23,093 | \$ (12,042) | \$ - | \$ 11,051 |

⁽¹⁾ Average rate or average price are on initiation of the derivatives, and refer to the average bond forward rate, the average rate on the fixed-leg of an interest rate swap, and the average share price of the total return swap. These rates/prices are applicable to derivatives in hedge accounting relationships only.

⁽²⁾ Positive current replacement cost represents the cost of replacing all contracts that have a positive fair value, using current market rates. The replacement cost is positive when the collateral held is less than the market value of the derivative contracts, and is calculated as outlined in OSFI's Capital Adequacy Requirements Guideline.

⁽³⁾ Credit risk equivalent represents the total replacement cost plus an amount representing the potential future credit exposure, as outlined in OSFI's Capital Adequacy Requirements Guideline.

⁽⁴⁾ Risk-weighted balance is determined by applying the standardized approach for counterparty credit risk to the credit equivalent amount, as prescribed by OSFI.

⁽⁵⁾ Derivative financial assets are included in Other assets (Note 14) and derivative financial liabilities are included in Other liabilities (Note 17).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2019 and 2018

(\$ THOUSANDS, EXCEPT SHARE, PER SHARE AND STOCK OPTION AMOUNTS)

| Derivative instrument and term (years) | December 31, 2018 | | | | | | | | |
|--|-------------------|------------------------------------|--|---|--------------------------------------|------------|-------------|----|--------------------|
| | Notional amount | Average Rate/ Price ⁽¹⁾ | Positive current replacement cost ⁽²⁾ | Credit equivalent amount ⁽³⁾ | Risk-weighted balance ⁽⁴⁾ | Fair value | | | Net ⁽⁵⁾ |
| | | | | | | Assets | Liabilities | | |
| Cash flow hedges: | | | | | | | | | |
| Bond forwards – hedge accounting | | | | | | | | | |
| 1 or less | \$ 69,100 | 2.72% | \$ - | \$ - | \$ - | \$ - | (1,143) | \$ | (1,143) |
| Interest rate swaps – hedge accounting | | | | | | | | | |
| 1 to 5 | 291,739 | 1.02% | 7,488 | 8,946 | 1,789 | 7,488 | - | | 7,488 |
| Total return swaps – hedge accounting | | | | | | | | | |
| 1 or less | 1,410 | 56.13 | 80 | 165 | 33 | 80 | - | | 80 |
| 1 to 5 | 4,195 | 58.96 | 139 | 474 | 95 | 139 | (99) | | 40 |
| Total return swaps – non-hedge accounting | | | | | | | | | |
| 1 or less | 2,403 | N/A | 130 | 274 | 55 | 130 | - | | 130 |
| Fair value hedges: | | | | | | | | | |
| Interest rate swaps – hedge accounting | | | | | | | | | |
| 1 or less | 160,000 | 1.68% | - | - | - | - | (899) | | (899) |
| 1 to 5 | 1,395,000 | 2.30% | 8,153 | 15,129 | 3,026 | 8,153 | (5,077) | | 3,076 |
| 5 and above | 88,548 | 2.32% | 597 | 1,925 | 385 | 597 | (1,289) | | (692) |
| Interest rate swaps – non-hedge accounting | | | | | | | | | |
| 5 and above | 1,300 | N/A | 77 | 96 | 19 | 77 | - | | 77 |
| Bond forwards – non-hedge accounting | | | | | | | | | |
| 1 or less | 66,350 | N/A | - | - | - | - | (1,188) | | (1,188) |
| Other derivatives: | | | | | | | | | |
| Total return swaps | | | | | | | | | |
| 1 to 5 | 1,709,623 | N/A | 278 | 8,826 | 1,765 | 278 | (1,457) | | (1,179) |
| 5 and above | 856,092 | N/A | 1,077 | 13,918 | 2,784 | 1,077 | (2,151) | | (1,074) |
| | \$ 4,645,760 | | \$ 18,019 | \$ 49,753 | \$ 9,951 | \$ 18,019 | \$ (13,303) | \$ | 4,716 |

⁽¹⁾ Average rate or average price are on initiation of the derivatives, and refer to the average bond forward rate, the average rate on the fixed-leg of an interest rate swap, and the average share price of the total return swap. These rates/prices are applicable to derivatives in hedge accounting relationships only.

⁽²⁾ Positive current replacement cost represents the cost of replacing all contracts that have a positive fair value, using current market rates. It reflects the unrealized gains on derivative instruments.

⁽³⁾ Credit risk equivalent represents the total replacement cost plus an amount representing the potential future credit exposure, as outlined in OSFI's Capital Adequacy Requirements Guideline.

⁽⁴⁾ Risk-weighted balance is determined by applying the standardized approach for counterparty credit risk to the credit equivalent amount, as prescribed by OSFI.

⁽⁵⁾ Derivative financial assets are included in Other assets (Note 14) and derivative financial liabilities are included in Other liabilities (Note 17).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2019 and 2018

(\$ THOUSANDS, EXCEPT SHARE, PER SHARE AND STOCK OPTION AMOUNTS)

Cash flow hedges:

The following table presents the effects of cash flow hedges on the Company's Consolidated Statements of Income:

| | 2019 | | | |
|---------------------|--|-------------------------------------|--|--|
| | Gains (losses) on hedging instrument | Gains (losses) on hedged Item | Hedge ineffectiveness recognized in income | Hedging gain or loss recognized in OCI |
| Cash flow hedges: | | | | |
| Interest rate risk: | | | | |
| Bond forwards | \$ (6,045) | \$ 5,852 | \$ (250) | \$ (5,795) |
| Interest rate swaps | (450) | 450 | - | (450) |
| Equity price risk: | | | | |
| Total return swaps | 5,351 | (5,351) | - | 5,351 |
| | \$ (1,144) | \$ 951 | \$ (250) | \$ (894) |
| | | | | 2018 |
| | Gains (losses) on hedging instrument | Gains (losses) on hedged Item | Hedge ineffectiveness recognized in income | Hedging gain or loss recognized in OCI |
| Cash flow hedges: | | | | |
| Interest rate risk: | | | | |
| Bond forwards | \$ 254 | \$ (263) | \$ 74 | \$ 180 |
| Interest rate swaps | (2,710) | 2,710 | - | (2,710) |
| Equity price risk: | | | | |
| Total return swaps | (441) | 441 | - | (441) |
| | \$ (2,897) | \$ 2,888 | \$ 74 | \$ (2,971) |

The following table presents the effects of cash flow hedges on the Company's Consolidated Statements of Comprehensive Income on a pre-tax basis:

| | 2019 | | | | | | |
|---------------------|----------------------------------|---|--|---------------------------------|---------------------------------|------------------------|--|
| | AOCI as at January 1, 2019 | Net gains (losses) recognized in OCI | Amount reclassified to income as the hedged Item affects income | AOCI as at December 31, 2019 | Balance in cash flow hedge AOCI | | |
| | | | | | Active hedges | Discontinued hedges | |
| Cash flow hedges: | | | | | | | |
| Interest rate risk: | | | | | | | |
| Bond forwards | \$ (4,187) | \$ (5,795) | \$ 1,926 | \$ (8,056) | \$ 881 | \$ (8,937) | |
| Interest rate swaps | 7,488 | (450) | (1,079) | 5,959 | 4,568 | 1,391 | |
| Equity price risk: | | | | | | | |
| Total return swaps | 7 | 5,351 | (3,235) | 2,123 | 2,119 | 4 | |
| | \$ 3,308 | \$ (894) | \$ (2,388) | \$ 26 | \$ 7,568 | \$ (7,542) | |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2019 and 2018

(\$ THOUSANDS, EXCEPT SHARE, PER SHARE AND STOCK OPTION AMOUNTS)

| | 2018 | | | | | | |
|---------------------|----------------------------------|---|--|---------------------------------|---------------------------------|------------------------|--|
| | AOCI as at January 1, 2018 | Net gains (losses) recognized in OCI | Amount reclassified to income as the hedged Item affects income | AOCI as at December 31, 2018 | Balance in cash flow hedge AOCI | | |
| | | | | | Active hedges | Discontinued hedges | |
| Cash flow hedges: | | | | | | | |
| Interest rate risk: | | | | | | | |
| Bond forwards | \$ (6,403) | \$ 180 | \$ 2,036 | \$ (4,187) | \$ (1,130) | \$ (3,057) | |
| Interest rate swaps | 10,198 | (2,710) | - | 7,488 | 7,488 | - | |
| Equity price risk: | | | | | | | |
| Total return swaps | 199 | (441) | 249 | 7 | 128 | (121) | |
| | \$ 3,994 | \$ (2,971) | \$ 2,285 | \$ 3,308 | \$ 6,486 | \$ (3,178) | |

Fair value hedges:

The following table presents the effects of fair value hedges on the Company's Consolidated Balance Sheets and the Consolidated Statements of Income:

| | 2019 | | | | | | | |
|----------------------------|---|--|----------|--|------------------------|--|------------------------|--|
| | Hedge ineffectiveness | | | Carrying amounts for hedged items ⁽¹⁾ | | Accumulated amount of fair value hedge gains(losses) on the hedged item | | |
| | Gains (losses) on hedging instrument | Gains (losses) on hedged item | Total | Active hedges | Discontinued hedges | Active hedges | Discontinued hedges | |
| Fair value hedges: | | | | | | | | |
| Interest rate risk: | | | | | | | | |
| Loans | \$ 2,187 | \$ (2,122) | \$ 65 | \$ 234,037 | \$ - | \$ (2,122) | \$ - | |
| Securitization liabilities | (779) | 139 | (640) | (80,439) | (142,177) | 1,252 | (319) | |
| Deposits | 11,914 | (11,930) | (16) | (795,454) | (1,689,817) | (510) | (10,305) | |
| | \$ 13,322 | \$ (13,913) | \$ (591) | \$ (641,856) | \$ (1,831,994) | \$ (1,380) | \$ (10,624) | |
| | 2018 | | | | | | | |
| | Hedge ineffectiveness | | | Carrying amounts for hedged items ⁽¹⁾ | | Accumulated amount of fair value hedge gains (losses) on the hedged item | | |
| | Gains (losses) on hedging instrument | Gains (losses) on hedged item | Total | Active hedges | Discontinued hedges | Active hedges | Discontinued hedges | |
| Fair value hedges: | | | | | | | | |
| Interest rate risk: | | | | | | | | |
| Securitization liabilities | \$ 464 | \$ (442) | \$ 22 | \$ (87,794) | \$ - | \$ 755 | \$ - | |
| Deposits | 8,696 | (9,163) | (467) | (1,529,009) | (282,184) | (1,682) | 1,327 | |
| | \$ 9,160 | \$ (9,605) | \$ (445) | \$ (1,616,803) | \$ (282,184) | \$ (927) | \$ 1,327 | |

⁽¹⁾ Represents the carrying value of hedged items designated in qualifying hedging relationships.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2019 and 2018

(\$ THOUSANDS, EXCEPT SHARE, PER SHARE AND STOCK OPTION AMOUNTS)

Note 13 – Offsetting Financial Assets and Financial Liabilities

The disclosures in the table below include financial assets and financial liabilities that may or may not be offset in the consolidated financial statements but are subject to agreements with netting arrangements which covers similar financial instruments irrespective of whether they are offset in the consolidated financial statements. Such agreements include derivative agreements, collateral support agreements and repurchase agreements. Financial instruments include derivatives, securities purchased under reverse repurchase agreements and obligations under repurchase agreements.

The Company's derivative transactions are entered into under ISDA master agreements. In general, amounts owed by each counterparty under an agreement are aggregated into a single net amount being payable by one party to the other. In certain cases all outstanding transactions under an agreement may be terminated and a single net amount including pledges is due or payable in settlement of these transactions.

The Company's securities purchased under reverse repurchase agreements and obligations under repurchase agreements are covered by industry standard master agreements, which include netting provisions.

The Company pledges and in certain cases receives collateral in the form of cash or securities in respect of the financial instruments. Such collateral is subject to the credit support agreement associated with ISDA agreements, or subject to global master repurchase agreements. Under this agreement, cash or securities pledged/received as collateral can be sold during the term of the transaction but must be returned when the collateral is no longer required and/or on maturity. The terms also give each counterparty the right to terminate the related transactions upon the counterparty's failure to post collateral.

As of December 31, 2019, the approximate market value of cash and securities collateral pledged by the Company that are subject to credit support agreements was \$514,870 (December 31, 2018 – \$344,395).

As of December 31, 2019, the approximate market value of cash and securities collateral accepted that may be sold or repledged by the Company was \$158,195 (December 31, 2018 – \$255,297). There was no collateral sold or repledged in 2019 and 2018.

Financial assets subject to offsetting, enforceable master netting arrangements and similar agreements:

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2019 and 2018

(\$ THOUSANDS, EXCEPT SHARE, PER SHARE AND STOCK OPTION AMOUNTS)

| Types of financial assets | 2019 | | | | | |
|--|---|---|--|--|--|---------------|
| | | | | Related amounts not offset on the consolidated balance sheets | | |
| | Gross amounts of recognized financial assets | Gross amounts of recognized financial liabilities offset on the consolidated balance sheets | Net amounts of financial assets presented on the consolidated balance sheets | Financial instruments | Financial collateral (including cash collateral received) | Net amount |
| Derivatives held for risk management: | | | | | | |
| Interest rate swaps | \$ 14,468 | \$ - | \$ 14,468 | \$ - | \$ (8,098) | \$ 6,370 |
| Total return swaps | 6,686 | - | 6,686 | - | (4,034) | 2,652 |
| Securities purchased under reverse repurchase agreements | 150,069 | - | 150,069 | - | (150,069) | - |
| | \$ 171,223 | \$ - | \$ 171,223 | \$ - | \$ (162,201) | \$ 9,022 |

Financial liabilities subject to offsetting, enforceable master netting arrangements and similar agreements:

| Types of financial liabilities | 2019 | | | | | |
|---|--|--|---|--|---|---------------|
| | | | | Related amounts not offset on the consolidated balance sheets | | |
| | Gross amounts of recognized financial liabilities | Gross amounts of recognized financial assets offset on the consolidated balance sheets | Net amounts of financial liabilities presented on the consolidated balance sheets | Financial instruments | Financial collateral (including cash collateral pledged) | Net amount |
| Derivatives held for risk management: | | | | | | |
| Interest rate swaps | \$ 4,959 | \$ - | \$ 4,959 | \$ - | \$ (3,530) | \$ 1,429 |
| Total return swaps | 7,083 | - | 7,083 | - | (3,283) | 3,800 |
| Obligations under repurchase agreements | 507,044 | - | 507,044 | (507,044) | - | - |
| | \$ 519,086 | \$ - | \$ 519,086 | \$ (507,044) | \$ (6,813) | \$ 5,229 |

Financial assets subject to offsetting, enforceable master netting arrangements and similar agreements:

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2019 and 2018

(\$ THOUSANDS, EXCEPT SHARE, PER SHARE AND STOCK OPTION AMOUNTS)

| Types of financial assets | 2018 | | | | | |
|---|---|---|--|--|--|---------------|
| | Gross amounts of recognized financial assets | Gross amounts of recognized financial liabilities offset on the consolidated balance sheets | Net amounts of financial assets presented on the consolidated balance sheets | Related amounts not offset on the consolidated balance sheets | | Net amount |
| | | | | Financial instruments | Financial collateral (including cash collateral received) | |
| Derivatives held for risk management: | | | | | | |
| Interest rate swaps | \$ 16,315 | \$ - | \$ 16,315 | \$ - | \$ (9,884) | \$ 6,431 |
| Total return swaps | 1,704 | - | 1,704 | - | (1,556) | 148 |
| Securities purchased under reverse repurchase agreements | 250,000 | - | 250,000 | - | (250,000) | - |
| | \$ 268,019 | \$ - | \$ 268,019 | \$ - | \$ (261,440) | \$ 6,579 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2019 and 2018

(\$ THOUSANDS, EXCEPT SHARE, PER SHARE AND STOCK OPTION AMOUNTS)

Financial liabilities subject to offsetting, enforceable master netting arrangements and similar agreements:

| Types of financial liabilities | 2018 | | | | | |
|---|---|--|---|-----------------------|---|------------|
| | Gross amounts of recognized financial liabilities | Gross amounts of recognized financial assets offset on the consolidated balance sheets | Net amounts of financial liabilities presented on the consolidated balance sheets | Financial instruments | Related amounts not offset on the consolidated balance sheets Financial collateral (including cash collateral pledged) | Net amount |
| Derivatives held for risk management: | | | | | | |
| Interest rate swaps | \$ 7,265 | \$ - | \$ 7,265 | \$ - | \$ (4,105) | \$ 3,160 |
| Total return swaps | 3,707 | - | 3,707 | - | (1,886) | 1,821 |
| Obligations under repurchase agreements | 342,010 | - | 342,010 | (342,010) | - | - |
| | \$ 352,982 | \$ - | \$ 352,982 | \$ (342,010) | \$ (5,991) | \$ 4,981 |

Note 14 – Other Assets

| | December 31, 2019 | December 31, 2018 |
|---|-------------------|-------------------|
| Intangible assets | \$ 53,536 | \$ 34,068 |
| Property and equipment | 17,754 | 17,519 |
| Goodwill | 16,944 | - |
| Receivable relating to securitization activities | 16,589 | 12,026 |
| Prepaid expenses and other | 14,648 | 58,743 |
| Right-of-use assets | 13,554 | - |
| Accrued interest and dividends on non-loan assets | 3,008 | 1,174 |
| Real estate owned | 1,551 | 1,368 |
| Deferred cost – Contingent liquidity facility | 411 | 1,864 |
| Derivative financial instruments: | | |
| Interest rate swaps | 14,468 | 16,315 |
| Total return swaps | 6,686 | 1,704 |
| Bond forwards | 1,939 | - |
| Income taxes receivable | - | 2,835 |
| Loan commitments | - | 55 |
| | \$ 161,088 | \$ 147,671 |

Intangible assets include system, and software development costs relating to the Company's information systems.

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Years ended December 31, 2019 and 2018

(\$ THOUSANDS, EXCEPT SHARE, PER SHARE AND STOCK OPTION AMOUNTS)

The Company has recognized right-of-use assets for its leased office premises located in Toronto, Oakville, Calgary, Montreal and Vancouver, and for its leased data centres as follows:

| | 2019 |
|---|-----------|
| Carrying amount of right-of-use assets | \$ 13,554 |
| Depreciation charge for right-of-use assets | 2,506 |
| Cash outflows for lease liabilities | 3,162 |
| Interest expense on lease liabilities | 811 |

Note 15 – Deposits

| | December 31, 2019 | December 31, 2018 |
|------------------------------------|-------------------|-------------------|
| Term and other deposits | \$ 15,231,888 | \$ 13,522,012 |
| Accrued interest | 241,406 | 178,028 |
| Deferred deposit agent commissions | (31,087) | (31,519) |
| | \$ 15,442,207 | \$ 13,668,521 |

Note 16 – Income Taxes

(a) Income tax provision:

| | 2019 | 2018 |
|-----------------------------------|-----------|-----------|
| Current tax expense: | | |
| Current year | \$ 73,810 | \$ 54,776 |
| Adjustments for prior years | 67 | (402) |
| | 73,877 | 54,374 |
| Deferred tax expense: | | |
| Reversal of temporary differences | (818) | 4,333 |
| Adjustments for prior years | (80) | 239 |
| Changes in tax rates | (361) | 22 |
| | (1,259) | 4,594 |
| Total income tax expense | \$ 72,618 | \$ 58,968 |

The provision for income taxes shown in the Consolidated Statements of Income differs from that obtained by applying statutory income tax rates to income before provision for income taxes due to the following reasons:

| | 2019 | 2018 |
|-------------------------------------|--------|--------|
| Canadian statutory income tax rate | 26.5% | 26.6% |
| Increase (decrease) resulting from: | | |
| Tax-exempt income | (0.6%) | (0.7%) |
| Future tax rate changes | (0.1%) | - |
| Non-deductible expenses and other | 0.2% | 0.4% |
| Effective income tax rate | 26.0% | 26.3% |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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(\$ THOUSANDS, EXCEPT SHARE, PER SHARE AND STOCK OPTION AMOUNTS)

(b) Deferred tax liabilities:

Net deferred income tax liabilities are comprised of:

| | December 31, 2019 | December 31, 2018 |
|-------------------------------------|-------------------|-------------------|
| Deferred income tax assets: | | |
| Tax losses ⁽¹⁾ | \$ 11,068 | \$ - |
| Allowance for credit losses | 6,657 | 6,356 |
| Share issue expenses | 101 | 198 |
| Net loan fees | 2,440 | - |
| Other | 2,507 | 1,436 |
| | 22,773 | 7,990 |
| Deferred income tax liabilities: | | |
| Securitization activities | 39,907 | 33,304 |
| Leasing activities ⁽²⁾ | 25,465 | - |
| Deposit agent commissions | 7,929 | 8,364 |
| Net origination fees | - | 4,361 |
| Intangible costs | 2,222 | 2,666 |
| Other | 1,939 | 1,905 |
| | 77,462 | 50,600 |
| Net deferred income tax liabilities | \$ 54,689 | \$ 42,610 |

⁽¹⁾ Deferred tax asset pertains to income tax losses of approximately \$39,800 from the finance lease business.

⁽²⁾ The deferred tax liability relating to leasing activities pertain to the temporary difference resulting from difference in accounting treatment versus tax treatment for finance lease receivable.

Note 17 – Other Liabilities

| | December 31, 2019 | December 31, 2018 |
|--|-------------------|-------------------|
| Accounts payable and accrued liabilities | \$ 86,917 | \$ 79,242 |
| Loan realty taxes | 50,302 | 58,594 |
| Securitized loan servicing liability | 27,774 | 26,822 |
| Income taxes payable | 21,120 | - |
| Right-of-use liabilities | 15,478 | - |
| Loan commitments | 209 | - |
| Derivative financial instruments: | | |
| Total return swaps | 7,083 | 3,707 |
| Interest rate swaps | 4,959 | 7,265 |
| Bond forwards | - | 2,331 |
| | \$ 213,842 | \$ 177,961 |

Accounts payable and accrued liabilities include \$26,230 (December 31, 2018 – \$39,356) relating to obligations associated with the purchase of the Maple portfolio in 2016.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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Note 18 – Bank Facilities

(a) Operating credit facility:

The Company has a \$35,000 credit facility in place with a major Schedule I Canadian bank. The facility is secured by a portion of the Company's investments in equity securities. There was no outstanding balance as at December 31, 2019 and December 31, 2018.

(b) Secured funding facilities:

The Company has two credit facilities totaling \$600,000 with major Schedule I Canadian banks to finance insured residential loans prior to securitization. The balance outstanding on these facilities as at December 31, 2019 is \$nil (December 31, 2018 – \$289,971).

(c) Backstop funding facility:

During the year, the Company reduced the size of its secured backstop funding facility to \$400,000 from \$850,000 and renewed this facility for an additional 2 years. The terms of the renewal for the facility include a 0.1% commitment fee, a 0.55% standby fee on any unused portion of the facility, and an interest rate on the drawn portion of the facility equal to 3 month CDOR + 1.25%. The Company has not made any draws on this facility since its inception.

Note 19 – Shareholders' Equity

(a) Capital stock:

Authorized:

- Unlimited number of non-cumulative 5-year rate reset preferred shares, Series 1, par value \$25.00 per share
- Unlimited number of non-cumulative floating rate preferred shares, Series 2, par value \$25.00 per share
- Unlimited number of non-cumulative 5-year rate reset preferred shares, Series 3, par value \$25.00 per share
- Unlimited number of non-cumulative floating rate preferred shares, Series 4, par value \$25.00 per share
- Unlimited number of common shares, no par value

Issued and outstanding shares:

| | December 31, 2019 | | | December 31, 2018 | | |
|--|-------------------|------------|------------------------------------|-------------------|------------|------------------------------------|
| | Number of shares | Amount | Dividends per share ⁽¹⁾ | Number of shares | Amount | Dividends per share ⁽¹⁾ |
| Preferred Shares, Series 3 | 3,000,000 | \$ 72,557 | 1.56 | 3,000,000 | \$ 72,557 | 1.59 |
| | | | | | | |
| | 2019 | | | 2018 | | |
| | Number of shares | Amount | Dividends per share ⁽¹⁾ | Number of shares | Amount | Dividends per share ⁽¹⁾ |
| Common shares: | | | | | | |
| Balance, beginning of year | 16,554,018 | \$ 200,792 | | 16,503,437 | \$ 198,660 | |
| Contributions from exercise of stock options | 220,364 | 10,825 | | 50,581 | 1,780 | |
| Issuance under DRIP | 23,211 | - | | - | - | |
| Transferred from contributed surplus relating to the exercise of stock options | - | 1,660 | | - | 352 | |
| Balance, end of year | 16,797,593 | \$ 213,277 | 1.29 | 16,554,018 | \$ 200,792 | 1.08 |

⁽¹⁾ Dividends per share represent dividends declared by the Company during the year.

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(b) Preferred shares:

Series 3 – 5-year rate reset preferred shares

Holders of Series 3 preferred shares were entitled to receive a fixed quarterly non-cumulative preferential cash dividends, as and when declared by the Board of Directors, at a per annum rate of 6.35% per share for an initial 5-year period ended September 30, 2019. Thereafter, the dividend rate was reset at a level of 4.78% per share over the then five-year Government of Canada bond yield. The rate was reset to 5.969% per share per annum on September 30, 2019. Series 3 preferred shares are redeemable in cash at the Company's option, subject to prior regulatory approval, on September 30 every five years thereafter, in whole or in part, at a price of \$25.00 per share plus all declared and unpaid dividends at the date fixed for redemption. Series 3 preferred shares are convertible at the holder's option to non-cumulative floating rate preferred shares, Series 4 (the "Series 4 preferred shares"), subject to certain conditions, on September 30 every five years thereafter.

Series 4 – floating rate preferred shares

Holders of the Series 4 preferred shares will be entitled to receive a floating rate quarterly non-cumulative preferential cash dividend equal to the 90-day Canadian Treasury Bill Rate plus 4.78%, as and when declared by the Board of Directors. Series 4 preferred shares are redeemable in cash at the Company's option, subject to prior regulatory approval, on (i) September 30, 2024 and on September 30 every five years thereafter, in whole or in part, at a price of \$25.00 per share plus all declared and unpaid dividends at the date fixed for redemption; or (ii) \$25.50 plus all declared and unpaid dividends to the date fixed for redemption in the case of redemptions on any other date on or after September 30, 2019. Series 4 preferred shares are convertible at the holder's option to non-cumulative 5-year rate reset preferred shares, Series 3 (the "Series 3 preferred shares"), subject to certain conditions, on September 30, 2024 and on September 30 every five years thereafter.

(c) Dividend reinvestment plan:

The Company has a dividend reinvestment plan. Participation in the plan is optional and under the terms of the plan, cash dividends on common shares are used to purchase additional common shares at the volume weighted average trading price of the common shares on the TSX for the five trading days immediately preceding the dividend payment date, adjusted with discount. At the option of the Company, the common shares may be issued from the Company's treasury or acquired from the open market at market price. The Company activated the plan in Q1 2019.

(d) Dividend restrictions:

The Company's subsidiary, Equitable Bank, is subject to minimum capital requirements, as prescribed by OSFI under the Bank Act (Canada). The Bank must notify OSFI prior to the declaration of any dividend and must ensure that any such dividend declaration is done in accordance with the provisions of the Bank Act (Canada), and those OSFI guidelines relating to capital adequacy and liquidity.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2019 and 2018

(\$ THOUSANDS, EXCEPT SHARE, PER SHARE AND STOCK OPTION AMOUNTS)

Note 20 – Stock-based Compensation

(a) Stock-based compensation plan:

Under the Company's stock option plan, options on common shares are periodically granted to eligible participants for terms of seven years and vest over a four-year period. As at December 31, 2019, the maximum number of common shares available for issuance under the plan was 2,000,000 (December 31, 2018 – 1,475,570). The outstanding options expire on various dates to November 2026. A summary of the Company's stock option activity and related information for the years ended December 31, 2019 and December 31, 2018 is as follows:

| | 2019 | | 2018 | |
|--------------------------------|-------------------------|---------------------------------|-------------------------|---------------------------------|
| | Number of stock options | Weighted average exercise price | Number of stock options | Weighted average exercise price |
| Outstanding, beginning of year | 671,332 | \$ 52.59 | 619,771 | \$ 50.80 |
| Granted | 144,967 | 69.37 | 121,159 | 55.66 |
| Exercised | (220,364) | 41.15 | (50,581) | 35.18 |
| Forfeited/cancelled | (18,923) | 65.43 | (19,017) | 60.12 |
| Outstanding, end of year | 577,012 | \$ 60.75 | 671,332 | \$ 52.59 |
| Exercisable, end of year | 279,692 | \$ 56.99 | 394,903 | \$ 47.67 |

The following table summarizes information relating to stock options outstanding and exercisable as at December 31, 2019:

| Exercise price | Options outstanding | | Options exercisable |
|----------------|---------------------|---|---------------------|
| | Number outstanding | Weighted average remaining contractual life (years) | Number exercisable |
| \$ 36.11 | 9,561 | 0.2 | 9,561 |
| \$ 52.90 | 62,429 | 1.2 | 62,429 |
| \$ 59.98 | 65,868 | 2.2 | 65,868 |
| \$ 55.32 | 6,700 | 2.9 | 6,700 |
| \$ 53.15 | 96,799 | 3.2 | 69,048 |
| \$ 71.68 | 83,876 | 4.2 | 38,907 |
| \$ 55.25 | 4,500 | 4.6 | 2,000 |
| \$ 55.66 | 108,272 | 5.2 | 25,180 |
| \$ 67.77 | 133,007 | 6.2 | - |
| \$ 92.41 | 2,000 | 6.2 | - |
| \$ 113.26 | 4,000 | 6.9 | - |

Under the fair value-based method of accounting for stock options, the Company recorded compensation expense in the amount of \$1,598 (2018 – \$1,375) related to grants of options under the stock option plan. This amount was credited to Contributed surplus. The fair value of options granted during 2019 was estimated at the date of grant using the Black-Scholes valuation model, with the following assumptions:

| | 2019 | 2018 |
|--|----------|----------|
| Risk-free rate | 1.8% | 2.1% |
| Expected option life (years) | 4.8 | 4.8 |
| Expected volatility | 27.8% | 26.2% |
| Expected dividends | 1.8% | 1.5% |
| Weighted average fair value of each option granted | \$ 15.22 | \$ 13.67 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2019 and 2018

(\$ THOUSANDS, EXCEPT SHARE, PER SHARE AND STOCK OPTION AMOUNTS)

(b) Employee share purchase plan:

The Company has an ESP plan for eligible employees. Under the plan, eligible employees can contribute between 1% and 10% of their annual base salary towards the purchase of common shares of the Company. For each eligible contribution, the Company contributes 50% of the employee's contribution to purchase common shares of the Company up to a certain maximum per employee. During the year, the Company expensed \$986 (2018 – \$879) under this plan.

(c) Deferred share unit plan:

The Company has a DSU plan for Directors. Under the plan, notional units are allocated to a Director from time to time by the Board of Directors and the units vest at the time of the grant. Directors can elect, on a one-time annual basis, to receive up to 100% of their annual compensation in the form of DSUs, allocated at each quarter and on a pro-rata basis. A Director will be credited with additional DSUs whenever a cash dividend is declared by the Company. When an individual ceases to be a Director (the "Separation Date"), the individual may elect up to two separate redemption dates to be paid out the value of the DSUs. The redemption date elected by the participant is a date after the Separation Date and no later than December 15 of the first calendar year commencing after the Separation Date. The redemption value of each DSU redeemable by a Director is the volume-weighted average trading price of the common shares of the Company on the TSX for the five trading days immediately prior to the redemption date.

In the event of any stock dividend, stock split, reverse stock split, consolidation, subdivision, reclassification, or any other change in the capital of the Company affecting its common shares, the Company will make, with respect to the number of DSUs outstanding under the DSU Plan, any proportionate adjustment as it considers appropriate to reflect that change. The DSU plan is administered by the Board or a committee thereof.

The Company hedges the risk of change in future cash flows related to the DSU plan. Please refer to Note 12 – Derivative Financial Instruments for further details.

A summary of the Company's DSU activity for the years ended December 31, 2019 and December 31, 2018 is as follows:

| | December 31, 2019 | December 31, 2018 |
|--------------------------------|-------------------|-------------------|
| | Number of DSUs | Number of DSUs |
| Outstanding, beginning of year | 42,697 | 32,915 |
| Granted | 10,593 | 11,051 |
| Dividend Reinvested | 947 | 602 |
| Paid out | - | (1,871) |
| Outstanding, end of year | 54,237 | 42,697 |

During the year, nil (2018 – 1,871) DSUs were paid out for a total value of \$nil (2018 – \$121). Compensation expense, including offsetting hedges, relating to DSUs outstanding during the year ended December 31, 2019 amounted to \$882 (2018 – \$687). The liability associated with DSUs outstanding as at December 31, 2019 was \$6,062 (December 31, 2018 – \$2,533) and was included in other liabilities on the Consolidated Balance Sheets.

(d) Restricted share unit plan:

The Company has a RSU plan for eligible employees. Under the plan, RSUs or PSUs are awarded by the Board to eligible employees during the annual compensation process and vest at the end of three years ("cliff vest"). Under the plan, each RSU or PSU represents one notional common share and earns notional dividends, which are re-invested into additional RSUs or PSUs when cash dividends are paid on the Company's common shares. Each RSU or PSU held at the end of the vesting period, including those acquired as dividend equivalents, will be paid to the eligible employees in cash, the value of which

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2019 and 2018

(\$ THOUSANDS, EXCEPT SHARE, PER SHARE AND STOCK OPTION AMOUNTS)

will be based on the volume-weighted average trading price of the Company's common shares on the TSX for the five consecutive trading days immediately prior to, and including the vesting date. The value of PSUs may be increased or decreased up to 25%, based on the Company's relative total shareholder return compared to a defined peer group of financial institutions in Canada.

The Company hedges the risk of change in future cash flows related to the RSU and PSU plans. Please refer to Note 12 – Derivative Financial Instruments for further details.

A summary of the Company's RSU and PSU activity for the years ended December 31, 2019 and December 31, 2018 is as follows:

| | December 31, 2019 | December 31, 2018 |
|--------------------------------|----------------------------|----------------------------|
| | Number of RSUs and PSUs | Number of RSUs and PSUs |
| Outstanding, beginning of year | 67,180 | 56,762 |
| Granted | 47,241 | 44,021 |
| Dividend reinvested | 1,896 | 1,519 |
| Vested and paid out | (25,066) | (31,202) |
| Forfeited/cancelled | (4,916) | (3,920) |
| Outstanding, end of year | 86,335 | 67,180 |

During the year, 25,066 (2018 – 31,202) RSUs and PSUs were vested and paid out for a total value of \$3,057 (2018 – \$1,944). Compensation expense, including offsetting hedges, relating to RSUs and PSUs outstanding during the year ended December 31, 2019 amounted to \$2,381 (2018 – \$2,276). The liability associated with RSUs and PSUs outstanding as at December 31, 2019 was \$4,463 (December 31, 2018 – \$1,707) and was included in other liabilities on the Consolidated Balance Sheets.

Note 21 – Earnings Per Share

Diluted earnings per share is calculated based on net income available to common shareholders divided by the weighted average number of common shares outstanding during the year, taking into account the dilution effect of stock options using the treasury stock method.

| | 2019 | 2018 |
|---|------------|------------|
| Earnings per common share – basic: | | |
| Net income | \$ 206,479 | \$ 165,626 |
| Dividends on preferred shares | 4,691 | 4,763 |
| Net income available to common shareholders | \$ 201,788 | \$ 160,863 |
| Weighted average basic number of common shares outstanding | 16,672,068 | 16,526,676 |
| Earnings per common share – basic | \$ 12.10 | \$ 9.73 |
| Earnings per common share – diluted: | | |
| Net income available to common shareholders | \$ 201,788 | \$ 160,863 |
| Weighted average basic number of common shares outstanding | 16,672,068 | 16,526,676 |
| Adjustment to weighted average number of common shares outstanding: | | |
| Stock options | 185,294 | 113,419 |
| Weighted average diluted number of common shares outstanding | 16,857,362 | 16,640,095 |
| Earnings per common share – diluted | \$ 11.97 | \$ 9.67 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2019 and 2018

(\$ THOUSANDS, EXCEPT SHARE, PER SHARE AND STOCK OPTION AMOUNTS)

For the year ended December 31, 2019, the calculation of the diluted earnings per share excluded 115,883 (2018 – 159,911) average options outstanding with a weighted average exercise price of \$69.66 (2018 – \$66.22) as the exercise price of these options was greater than the average price of the Company’s common shares.

Note 22 – Capital Management

Equitable Bank manages its capital in accordance with guidelines established by OSFI, based on standards issued by the Bank for International Settlements’ Basel Committee on Banking Supervision. OSFI’s Capital Adequacy Requirements (“CAR”) Guideline details how Basel III rules apply to Canadian banks. OSFI has mandated that all Canadian-regulated financial institutions meet target Capital Ratios: those being a CET1 Ratio of 7.0%, a Tier 1 Capital Ratio of 8.5%, and a Total Capital Ratio of 10.5%. In order to govern the quality and quantity of capital necessary based on the Bank’s inherent risks, Equitable Bank utilizes an Internal Capital Adequacy Assessment Process (“ICAAP”).

The Bank’s CET1 Ratio was 13.6% as at December 31, 2019, while Tier 1 Capital and Total Capital Ratios were 14.4% and 14.7% respectively. The Bank’s Capital Ratios at December 31, 2019 exceeded the regulatory minimums.

During the year, the Bank complied with all internal and external capital requirements.

Regulatory capital (relating solely to Equitable Bank) is as follows:

| | December 31, 2019 | December 31, 2018 |
|---|---------------------|-------------------|
| Common Equity Tier 1 Capital: | | |
| Common shares | \$ 213,995 | \$ 203,270 |
| Contributed surplus | 8,065 | 8,127 |
| Retained earnings | 1,191,562 | 1,011,052 |
| Accumulated other comprehensive loss ⁽¹⁾ | (18,827) | (17,565) |
| Less: Regulatory adjustments | (66,591) | (20,684) |
| Common Equity Tier 1 Capital | 1,328,204 | 1,184,200 |
| Additional Tier 1 Capital: | | |
| Non-cumulative preferred shares | 72,554 | 72,554 |
| Tier 1 Capital | 1,400,758 | 1,256,754 |
| Tier 2 Capital: | | |
| Eligible stage 1 and 2 allowance | 31,844 | 23,772 |
| Tier 2 Capital | 31,844 | 23,772 |
| Total Capital | \$ 1,432,602 | \$ 1,280,526 |

⁽¹⁾ As prescribed by OSFI (under Basel III rules), AOCI is part of CET1 in its entirety, however, the amount of cash flow hedge reserves that relates to the hedging of items that are not fair valued is excluded.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2019 and 2018

(\$ THOUSANDS, EXCEPT SHARE, PER SHARE AND STOCK OPTION AMOUNTS)

Note 23 – Commitments and Contingencies

(a) Lease commitments:

The Company is committed to leases for its office premises located in Toronto, Calgary, Montreal and Vancouver, and IT colocation. The future minimum lease payments under these leases are as follows:

| | December 31, 2019 | December 31, 2018 |
|----------------------|-------------------|-------------------|
| Less than 1 year | \$ 3,632 | \$ 2,561 |
| 1-5 years | 16,854 | 12,502 |
| Greater than 5 years | 432 | 2,538 |
| | \$ 20,918 | \$ 17,601 |

In addition to these minimum lease payments for premises rental, the Company will pay its share of common area maintenance and realty taxes over the terms of the leases. Lease expense recognized in the Consolidated Statements of Income for 2019 amounted to \$7,219 (2018 – \$5,183).

When measuring lease liabilities as at January 1, 2019 the Company discounted the operating lease commitments at 5% being the weighted average incremental borrowing rate. The following table shows a reconciliation between the opening operating lease commitments under IAS 17 and the lease liabilities recorded as at January 1, 2019:

| | January 1, 2019 |
|---|------------------|
| Operating lease commitments as at December 31, 2018 as disclosed under IAS 17 | \$ 17,601 |
| Operating lease commitments not within the scope of IAS 17 and not included as at December 31, 2018 | 1,694 |
| Non-lease component of commitments included as at December 31, 2018 | (1,667) |
| Operating lease commitments not considered as right-of-use assets | (240) |
| Operating lease commitments used for calculating right-of-use assets as at January 1, 2019 | \$ 17,388 |
| Lease liabilities by discounting commitments using the incremental borrowing rate as at January 1, 2019 | \$ 14,727 |

(b) Credit commitments:

As at December 31, 2019, the Company had outstanding commitments to fund \$1,935,712 (December 31, 2018 – \$1,544,683) of loans and investments in the ordinary course of business. Of these commitments, \$1,025,210 (December 31, 2018 – \$618,517) are expected to be funded within 1 year and \$910,502 (December 31, 2018 – \$926,167) after 1 year.

The Company has issued standby letters of credit which represent assurances that the Company will make payments in the event that a borrower cannot meet its obligations to a third party. Letter of credits in the amount of \$29,131 were outstanding at December 31, 2019 (December 31, 2018 – \$15,483).

(c) Contingencies:

In September 2013, the Company entered into an agreement to resolve the litigation related to an alleged fraud committed against it, which was identified in 2011. The net outstanding receivable balance is \$3,100 (December 31, 2018 – \$3,100) and the Company is currently pursuing a claim under our Financial Institution Bond, which is intended to protect against fraud losses. There is no assurance that proceeds or recoveries, if any, will be received in a timely manner from these additional actions or that such proceeds will be sufficient to recover the full amount of the receivable.

The Company is subject to various other claims and litigation arising from time to time in the ordinary course of business. Management has determined that the aggregate liability, if any, which may result from other various outstanding legal proceedings would not be material and no other provisions have been recorded in these consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2019 and 2018

(\$ THOUSANDS, EXCEPT SHARE, PER SHARE AND STOCK OPTION AMOUNTS)

Note 24 – Related Party Transactions

Parties are considered to be related if one party has the ability to directly or indirectly control the other party or exercise significant influence over the other party in making financial or operational decisions. The Company's related parties include key management personnel, close family members of key management personnel and entities which are controlled, significantly influenced by, or for which significant voting power is held by key management personnel or their close family members. Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company directly and indirectly. The Company considers the members of the Board of Directors as part of key management personnel.

These financial statements present the consolidated results of the Company and all its subsidiaries, therefore transactions with the subsidiaries are not reported as related party transactions.

(a) Key management personnel compensation table:

| | 2019 | 2018 |
|------------------------------|----------|----------|
| Short-term employee benefits | \$ 3,518 | \$ 3,395 |
| Post-employment benefits | 48 | 47 |
| Share-based payments (net) | 2,362 | 1,810 |
| | \$ 5,928 | \$ 5,252 |

(b) Share transactions, shareholdings and options of key management personnel and related parties:

As at December 31, 2019, key management personnel held 2,096,145 (December 31, 2018 – 2,215,648) common shares and 9,000 (December 31, 2018 – 9,000) preferred shares. These shareholdings include common shares of 1,825,300 (December 31, 2018 – 2,027,300) that were beneficially owned by the non-management Directors or held by related party entities whose controlling shareholders are Directors of the Company. In addition, key management held 317,078 (December 31, 2018 – 390,779) options to purchase common shares of the Company at prices ranging from \$52.90 to \$71.68.

(c) Other transactions:

As at December 31, 2019, deposits of \$1,395 (December 31, 2018 – \$1,106) were held by key management personnel and related party entities whose controlling shareholders are directors of the Company and trusts beneficially owned by the Directors.

During the year, loans of \$803 (2018 – nil) were given to key management personnel for the purpose of purchasing shares of the Company. The interest earned on the loans during the year was \$21 (2018 – \$nil), and the outstanding balance as at December 31, 2019 was \$nil (December 31, 2018 – \$nil).

These investments and loans were made in the ordinary course of business at terms comparable to those offered to unrelated parties.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2019 and 2018

(\$ THOUSANDS, EXCEPT SHARE, PER SHARE AND STOCK OPTION AMOUNTS)

Note 25 – Interest Rate Sensitivity

The following table shows the Company's position with regard to interest rate sensitivity of assets, liabilities and equity on the date of the earlier of contractual maturity or re-pricing date, as at December 31, 2019.

| | Floating rate | 0 to 3 months | 4 months to 1 year | Total within 1 year | 1 year to 5 years | Greater than 5 years | Non-interest sensitive ⁽¹⁾ | Total |
|--|---------------------|-----------------------|---------------------|-----------------------|----------------------|----------------------|---------------------------------------|----------------------|
| Assets: | | | | | | | | |
| Cash and cash equivalents and restricted cash | \$ 891,792 | \$ - | \$ - | \$ 891,792 | \$ - | \$ - | \$ - | \$ 891,792 |
| <i>Effective interest rate</i> | 2.15% | - | - | 2.15% | - | - | - | 2.15% |
| Securities purchased under reverse repurchase agreements | - | 150,069 | - | 150,069 | - | - | - | 150,069 |
| <i>Effective interest rate</i> | - | 1.67% | - | 1.67% | - | - | - | 1.67% |
| Investments | 16,050 | 139,324 | 42,155 | 197,529 | 237,895 | 26,500 | (20,328) | 441,596 |
| <i>Effective interest rate</i> | 5.49% | 2.27% | 3.26% | 2.74% | 3.91% | 2.92% | 0.00% | 3.51% |
| Loan receivable – Retail | 2,279,384 | 1,501,690 | 6,362,483 | 10,143,557 | 8,023,949 | 2,419 | 189,880 | 18,359,805 |
| <i>Effective interest rate</i> | 3.77% | 4.64% | 4.45% | 4.33% | 3.70% | 3.23% | - | 4.01% |
| Loan receivable – Commercial | 2,727,505 | 756,794 | 738,758 | 4,223,057 | 3,025,636 | 955,201 | 44,131 | 8,248,025 |
| <i>Effective interest rate</i> | 5.88% | 4.88% | 5.19% | 5.58% | 4.17% | 2.88% | - | 4.72% |
| Securitized Retained Interest | - | - | - | - | - | - | 140,077 | 140,077 |
| Other assets | - | - | - | - | - | - | 161,088 | 161,088 |
| Total assets | \$ 5,914,731 | \$ 2,547,877 | \$ 7,413,396 | \$ 15,606,004 | \$ 11,287,480 | \$ 984,120 | \$ 514,848 | \$ 28,392,452 |
| Liabilities: | | | | | | | | |
| Deposits ⁽²⁾ | \$ 182 | \$ 4,799,964 | \$ 4,599,246 | \$ 9,399,392 | \$ 5,824,052 | \$ - | \$ 218,763 | \$ 15,442,207 |
| <i>Effective interest rate</i> | 1.20% | 2.22% | 2.43% | 2.32% | 2.71% | - | - | 2.44% |
| Securitization liabilities | - | 2,914,470 | 1,470,140 | 4,384,610 | 5,446,074 | 810,901 | 65,371 | 10,706,956 |
| <i>Effective interest rate</i> | - | 2.64% | 2.83% | 2.71% | 2.87% | 2.84% | - | 2.78% |
| Obligations Under REPO | - | 507,044 | - | 507,044 | - | - | - | 507,044 |
| <i>Effective interest rate</i> | - | 1.99% | - | 1.99% | - | - | - | 1.99% |
| Other liabilities and deferred taxes | - | - | - | - | - | - | 268,531 | 268,531 |
| Shareholders' equity | - | - | - | - | 75,000 | - | 1,392,714 | 1,467,714 |
| Total liabilities and shareholders' equity | \$ 182 | \$ 8,221,478 | \$ 6,069,386 | \$ 14,291,046 | \$ 11,345,126 | \$ 810,901 | \$ 1,945,379 | \$ 28,392,452 |
| Off-balance sheet items ⁽³⁾ | \$ - | \$ (522,149) | \$ (311,613) | \$ (833,762) | \$ 779,271 | \$ 54,491 | \$ - | \$ - |
| Excess (deficiency) of assets over liabilities, shareholders' equity and off-balance sheet items | \$ 5,914,549 | \$ (6,195,750) | \$ 762,397 | \$ 481,196 | \$ 721,625 | \$ 227,710 | \$ (1,430,531) | \$ - |
| Total assets – 2018 | \$ 5,837,675 | \$ 1,991,005 | \$ 6,322,114 | \$ 14,150,794 | \$ 9,268,978 | \$ 1,188,408 | \$ 428,965 | \$ 25,037,145 |
| Total liabilities and shareholders' equity – 2018 | \$ 179 | \$ 6,452,357 | \$ 5,527,538 | \$ 11,980,074 | \$ 10,468,883 | \$ 995,694 | \$ 1,592,494 | \$ 25,037,145 |
| Off-balance sheet items – 2018 | \$ - | \$ (1,866,400) | \$ 164,160 | \$ (1,702,240) | \$ 1,643,147 | \$ 59,093 | \$ - | \$ - |
| Excess (deficiency) of assets over liabilities, shareholders' equity and off-balance sheet items – 2018 | \$ 5,837,496 | \$ (6,327,752) | \$ 958,736 | \$ 468,480 | \$ 443,242 | \$ 251,807 | \$ (1,163,529) | \$ - |

⁽¹⁾ Accrued interest is included in "Non-interest sensitive" assets and liabilities.

⁽²⁾ Cashable GIC deposits are included in the "0 to 3 months" as these are cashable by the depositor upon demand after 30 days from the date of issuance.

⁽³⁾ Off-balance sheet items include the Company's interest rate swaps, hedges on funded assets, as well as loan rate commitments that are not specifically hedged. Loan rate commitments that are specifically hedged, along with their respective hedges, are assumed to substantially offset.

DIRECTORS

Eric Beutel

Vice-President, Oakwest Corporation Limited, an investment holding company

Michael Emory

President and Chief Executive Officer, Allied Properties REIT

Susan Ericksen

Corporate Director

Kishore Kapoor

Interim President and Chief Executive Officer, GMP Capital Inc.

David LeGresley

Chair of the Board and a Corporate Director

Lynn McDonald

Corporate Director

Andrew Moor

President and Chief Executive Officer of Equitable Group Inc. and Equitable Bank

Rowan Saunders

President and Chief Executive Officer, Economical Mutual Insurance Company

Vincenza Sera

Corporate Director

Michael Stramaglia

Corporate Director and President and Founder of Matrisc Advisory Group Inc., a risk management consulting firm

EXECUTIVE OFFICERS

Andrew Moor

President and Chief Executive Officer

Ron Tratch

Senior Vice-President and Chief Risk Officer

Tim Wilson

Senior Vice-President and Chief Financial Officer

Dan Dickinson

Senior Vice-President and Chief Digital Officer

Kimberly Kukulowicz

Senior Vice-President, Marketing and Residential Sales

Brian Leland

Senior Vice-President, Residential Lending

Darren Lorimer

Senior Vice-President, Commercial Lending

Mahima Poddar

Senior Vice-President, Digital Banking and Strategy

Jody Sperling

Senior Vice-President, Human Resources

SHAREHOLDER AND CORPORATE INFORMATION

Corporate Head Office

Equitable Bank Tower
30 St. Clair Avenue West, Suite 700
Toronto, Ontario, Canada, M4V 3A1

Regional Offices:**Montreal**

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Calgary

906 12th Street S.W, Suite 700
Calgary, Alberta, Canada, T2R 1K7

Vancouver

777 Hornby Street, Suite 1240
Vancouver, British Columbia, Canada, V6Z 1S4

Halifax

1959 Upper Water Street, Suite 1300
Halifax, Nova Scotia, Canada, B3J 3N2

Website

www.equitablebank.ca

Toronto Stock Exchange Listings

Common Shares: EQB
Preferred Shares: EQB.PR.C

Quarterly Conference Call and Webcast

Tuesday, February 25, 2020, 8:30 a.m. EST
Live: 647.427.7450
Replay: 416.849.0833 (code 1180468)
Archive: www.equitablebank.ca

Investor Relations

Tim Wilson
Senior Vice-President and Chief Financial Officer
416.515.7000
Email: investor@equitablegroupinc.com

More comprehensive investor information including supplemental financial reports, quarterly news releases, and investor presentations is available in the Investor Relations at www.equitablebank.ca

Transfer Agent and Registrar

Computershare Investor Services Inc.
100 University Avenue, 8th Floor
Toronto, Ontario, Canada, M5J 2Y1
1.800.564.6253
Email: service@computershare.com

Annual Meeting of Shareholders

Friday, May 15, 2020
10:00 a.m. ET
Equitable Bank Tower
30 St. Clair Avenue West, 5th Floor
Toronto, Ontario, Canada, M4V 3A1