Financial Statements
(In Canadian dollars)

HABIB CANADIAN BANK

(A WHOLLY OWNED SUBSIDIARY OF
HABIB BANK AG ZURICH)

Year ended December 31, 2018

KPMG LLP
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INDEPENDENT AUDITORS' REPORT

To the Shareholders of Habib Canadian Bank

Opinion

We have audited the financial statements of Habib Canadian Bank (the Entity), which comprise:

- the statement of financial position as at December 31, 2018
- the statement of comprehensive income for the year then ended
- the statement of changes in shareholder's equity for the year then ended
- the statement of cash flows for the year then ended
- and notes to the 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 financial position of the Entity as at December 31, 2018, and its financial performance and its cash flows for the year 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.

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 International Financial Reporting Standards (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.

KPMG LLP

Chartered Professional Accountants, Licensed Public Accountants

Toronto, Canada

March 26, 2019

HABIB CANADIAN BANK

Statement of Financial Position
(In thousands of Canadian dollars)

December 31, 2018, with comparative information for 2017

	2018	2017
Cash and cash equivalents:		
Cash	$ 433	$ 440
Interest-bearing deposits with banks	60,122	60,734
Government of Canada treasury bill	9,960	9,968
	70,515	71,142
Loans and advances (notes 4 and 5)	152,423	128,345
Other:		
Customers' liability under acceptances	–	343
Derivative assets (note 14)	8	19
Office equipment and leasehold improvements (note 6)	693	1,007
Deferred tax assets (note 8)	218	377
Other assets	642	694
	1,561	2,440
	$ 224,499	$ 201,927

Liabilities and Shareholder's Equity

	2018	2017
Liabilities:		
Deposits (note 7):		
Individuals	$ 80,481	$ 77,258
Businesses	86,994	80,492
Deposit-taking institutions (note 10)	22,075	10,787
	189,550	168,537
Other:		
Acceptances	–	343
Derivative liabilities (note 14)	5	17
Other liabilities	2,722	1,896
	2,727	2,256
Shareholder's equity (100% attributable to Bank's owner):		
Capital stock:		
Issued and fully paid:		
3,000,000 common shares	30,000	30,000
Retained earnings	2,222	1,134
	32,222	31,134
Commitments and contingent liabilities (note 11)		
	$ 224,499	$ 201,927

See accompanying notes to financial statements.

On behalf of the Board:

Director

Director

HABIB CANADIAN BANK

Statement of Comprehensive Income
(In thousands of Canadian dollars)

Year ended December 31, 2018, with comparative information for 2017

	2018	2017
Interest income:		
Interest-bearing deposits with banks	$ 617	$ 568
Interest from Government of Canada treasury bill	124	64
Loans	7,421	5,223
	8,162	5,855
Interest expense:		
Deposits	1,829	1,371
Net interest income	6,333	4,484
Provision for (recovery of) credit losses (note 5(c))	21	(421)
Net interest income after provision for (recovery of) credit losses	6,312	4,905
Other income	1,755	1,550
Net interest and other income	8,067	6,455
Non-interest expenses:		
Salaries and staff benefits	3,728	3,369
Premises and equipment, including amortization	895	896
Other	2,319	1,990
	6,942	6,255
Income before income taxes	1,125	200
Income tax expense (note 8)	300	44
Total comprehensive income (100% attributable to Bank's owner) for the year	$ 825	$ 156

See accompanying notes to financial statements.

HABIB CANADIAN BANK

Statement of Changes in Shareholder's Equity
(In thousands of Canadian dollars)

Year ended December 31, 2018, with comparative information for 2017

Share capital (100% attributable to Bank's owner), January 1, 2017	$ 30,000
Increase in share capital during the year 2017	–
Share capital (100% attributable to Bank's owner), December 31, 2017	30,000
Retained earnings, beginning of year	978
Total comprehensive income for the year	156
Retained earnings, end of year	1,134
Shareholder's equity (100% attributable to Bank's owner), December 31, 2017	$ 31,134
Share capital (100% attributable to Bank's owner), January 1, 2018	$ 30,000
Increase in share capital during the year 2018	–
Share capital (100% attributable to Bank's owner), December 31, 2018	30,000
Retained earnings, beginning of year	1,134
Adjustment on initial application of IFRS 9, net of tax (note 4)	263
Total comprehensive income for the year	825
Retained earnings, end of year	2,222
Shareholder's equity (100% attributable to Bank's owner), December 31, 2018	$ 32,222

See accompanying notes to financial statements.

HABIB CANADIAN BANK

Statement of Cash Flows
(In thousands of Canadian dollars)

Year ended December 31, 2018, with comparative information for 2017

	2018	2017
Cash flows from (used in) operating activities:		
Total comprehensive income for the year	$ 825	$ 156
Adjustments:		
Depreciation	353	343
Provision for (recovery of) credit losses	21	(421)
Net interest income	(6,932)	(4,453)
Income tax expense	300	44
Gain on Government of Canada treasury bill	(124)	(64)
Change in derivative assets	11	(1)
Change in loans and advances	(23,718)	(21,541)
Change in other assets	51	(150)
Change in derivative liabilities	(12)	3
Change in deposits from individuals	3,223	3,671
Change in deposits from businesses	6,502	4,565
Change in deposits from deposit-taking institutions	11,288	(1,844)
Change in other liabilities and provisions	820	(654)
Interest received	8,235	5,694
Interest paid	(1,303)	(1,242)
Income taxes paid (recovered)	(236)	82
Net cash used in operating activities	(696)	(15,812)
Cash flows from (used in) investing activities:		
Interest-bearing deposits with banks	612	16,184
Government of Canada treasury bill	116	70
Acquisition of office equipment and leasehold improvements	(39)	(214)
Net cash from investing activities	689	16,040
Net increase (decrease) in cash	(7)	228
Cash, beginning of year	440	212
Cash, end of year	$ 433	$ 440

See accompanying notes to financial statements.

Habib Canadian Bank (the "Bank") is a 100% owned subsidiary of Habib Bank AG Zurich, Switzerland (the "Parent"), and is licensed to operate as a bank in Canada with full banking powers under the Bank Act.

The address of the Bank's registered office is 918 Dundas Street East, Suite 1-B, Mississauga, Ontario, L4Y 4H9. The Bank was incorporated on April 5, 2000 and commenced operations on March 22, 2001.

The address of the Parent is Weinbergstrasse 59 P.O. Box 225, 8042 Zurich, Switzerland.

The financial statements of the Bank as at and for the year ended December 31, 2018 comprise the Bank as a single economic unit - the Bank has no subsidiaries, associates and other entities to be consolidated in the Bank's financial statements.

The Bank primarily is involved in corporate and retail banking, and in providing trade finance services.

Basis of preparation:

(a) Statement of compliance:

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs"), as issued by the International Accounting Standards Board ("IASB").

This is the first set of the financial statements in which IFRS 9 Financial Instruments has been applied. As a result of the application of IFRS 9, the Bank changed its accounting policies in the areas specified below, and these new policies were applicable from January 1, 2018. As permitted by the transitional provisions of IFRS 9, the Bank elected not to restate comparative period results; accordingly, all comparative period information is presented in accordance with the previous accounting policies, as indicated below. Adjustments to carrying amounts of financial assets and liabilities at the date of initial application (January 1, 2018) were recognized in opening retained earnings. New or amended disclosures have been provided for the current period, where applicable, and comparative period disclosures are consistent with those made in the prior year.

The financial statements were authorized for issue by the Board of Directors on March 26, 2019.

Basis of preparation (continued):

(b) Basis of measurement:

The financial statements have been prepared on the historical cost basis, except for derivative financial instruments, which are measured at fair value.

(c) Functional and presentation currency:

These financial statements are presented in Canadian dollar, which is the Bank's functional currency. Except as otherwise indicated, financial information presented in Canadian dollars has been rounded to the nearest thousand.

(d) Use of estimates and judgements:

The preparation of the financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the year in which the estimate is revised and in any future years affected.

Information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognized in the financial statements are described in note 1(a), 1(g), 1(i) and 1(j).

1. Significant accounting policies:

The following note describes the Bank's significant accounting policies. These accounting policies have been applied consistently to all periods presented in these financial statements, except for changes to the accounting for financial instruments resulting from the adoption of IFRS 9, Financial Instruments ("IFRS 9"), and revenue recognition from the adoption of IFRS 15, Revenue from Contracts with Customers ("IFRS 15"). As a result, the Bank has changed its accounting policies as outlined below, effective January 1, 2018:

(a) Financial instruments:

The Bank's statement of financial position consists primarily of loans and advances and interest-bearing deposits with banks and the majority of its net income is derived from income from loans and deposits with banks.

Financial instruments assets include cash and cash equivalents, interest-bearing deposits with banks, Government of Canada treasury bill, loans and advances and derivative assets. Financial instrument liabilities include deposits, derivative liabilities and other liabilities.

(i) IFRS 9:

Effective January 1, 2018, the Bank adopted IFRS 9, which superseded International Accounting Standard ("IAS") 39, Financial Instruments - Recognition and Measurement ("IAS 39"). IFRS 9 addresses classification and measurement of financial assets and liabilities, impairment of financial assets, and hedge accounting. IFRS 9 was applied retrospectively without restatement of prior periods.

Classification, measurement and impairment of financial assets on adoption of IFRS 9, effective January 1, 2018:

Classification and measurement:

A financial asset is classified and measured based on the business model in which it is managed and the contractual cash flow characteristics of the financial asset. The adoption of the new classification and measurement requirements resulted in the Bank's financial assets and financial liabilities continuing to be measured at amortized cost with the exception of derivative assets and liabilities which are classified as fair value through profit and loss ("FVTPL") and measured at fair value.

1. Significant accounting policies (continued):

Impairment:

The impairment model for measuring impairment of financial assets at amortized cost changed from an incurred loss model to an expected credit loss ("ECL") model. ECL is based on probability of default ("PD"), loss given default ("LGD") and exposure at default ("EAD") inputs and takes into account the expected timing of the loss. The ECL model also incorporates forward-looking economic information, primarily forecasts of the unemployment rate, GDP, as well as the use of experienced credit judgement, where applicable. There is a significant amount of judgement involved in determining the ECL estimate.

Under IFRS 9, the allowance for loans for which credit risk had not increased significantly since initial recognition is measured at an amount equal to 12-month ECL ("Stage 1"). For loans that have experienced a significant increase in credit risk, the Bank recognizes an allowance at an amount equal to the lifetime ECL ("Stage 2"). The determination of a significant increase in credit risk takes into account relative changes in risk of default and includes all loans that are more than 30 days past due.

The allowance for loans that are individually identified as impaired ("Stage 3") is also measured at an amount equal to the lifetime ECL.

PD represents the likelihood that a loan will default over the following 12 months or, depending on credit deterioration from origination of the loan over the expected life of the loan. LGD is the amount that is expected not to be recovered in the event of default. EAD is the estimate of the outstanding amount of credit exposure at the time a default may occur. For undrawn amounts, EAD includes an estimate of any further amounts to be drawn at the time of default. These inputs are modelled based on historical data and reasonable and supportable information about future economic conditions, where appropriate.

Forward-looking macroeconomic information:

The Bank relies on a broad range of forward-looking macroeconomic factors, such as expected GDP growth and unemployment rates. The inputs used in the model for calculating ECL may not always capture all characteristics of the market at the date of the financial statements. To capture portfolio characteristics and risks, qualitative adjustments or overlays are made using management judgement.

1. Significant accounting policies (continued):

The Bank determines ECL using three 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 two additional scenarios representing more optimistic and more pessimistic outcomes.

Significant increase in credit risk:

At each reporting date, the Bank assesses whether there has been a significant increase in credit risk since initial recognition by comparing the risk of default occurring over the remaining expected life from the reporting date and the date of initial recognition. The assessment considers borrower-specific quantitative and qualitative information and the impact of forward-looking macroeconomic factors. For loans, significant increase in credit risk is assessed at the borrower level and considers the proportionate change in PD, as well as the absolute change in PD.

Definition of default and write-off:

The Bank considers a loan to be in default as a result of one or more loss events that occurred after the loss event has a negative impact on the estimated future cash flows of the loans that can be reliably estimated. The Bank considers that default has occurred and classifies the financial asset as impaired when it is more than 90 days past due.

The Bank writes-off an impaired financial asset and the related impairment allowance, either partially or in full, when there is no realistic prospect of recovery. In circumstances where the net realizable value of any collection has been determined and there is no reasonable expectation of further recovery, write-off may be earlier.

In subsequent periods, any recoveries of amounts previously written-off as a result of a debt sale or other repayment, the amount is credited to the provision for credit losses.

(ii) IFRS 15:

Effective January 1, 2018 the Bank adopted IFRS 15, which supersedes all previous revenue recognition requirements under IFRS. The standard establishes a single, five-step, structured model for recognizing revenue from contracts with customers.

1. Significant accounting policies (continued):

The adoption of IFRS 15 had no impact on the Bank's accounting for revenue recognition, in either the current period or via the permitted retrospective application. The Bank earns the majority of its revenue from financial instruments, which are accounted for under IFRS 9, which was also adopted on January 1, 2018.

(iii) Offsetting:

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Bank has a legally enforceable right to set off the 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 IFRSs, or for gains and losses arising from a group of similar transactions, such as in the Bank's trading activity.

(iv) Amortized cost measurement:

The amortized cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortization using the effective interest method of any difference between the initial amount recognized and the maturity amount, minus any reduction for impairment.

(v) Fair value measurement:

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's-length transaction on the measurement date.

When available, the Bank measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's-length basis.

1. Significant accounting policies (continued):

If a market for a financial instrument is not active, the Bank establishes fair value using a valuation technique. Valuation techniques include using recent arm's-length transactions between knowledgeable, willing parties (if available), reference to the current fair value of other instruments that are substantially the same, discounted cash flow analyses and option pricing models.

(vi) Identification and measurement of impairment - *policy applicable before January 1, 2018:*

At each reporting date, the Bank assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. A financial asset or a group of financial assets is impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset, and that the loss event has an impact on the future cash flows of the asset that can be estimated reliably.

Objective evidence that financial assets are impaired can include significant financial difficulty of the borrower or issuer, default or delinquency by a borrower, restructuring of a loan or advance by the Bank on terms that the Bank would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets, such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group.

The Bank considers evidence of impairment for loans and advances at both a specific asset and collective level. All individually significant loans and advances are assessed for specific impairment. All individually significant loans and advances found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Loans and advances that are not individually significant are collectively assessed for impairment by grouping together loans and advances with similar risk characteristics.

In assessing collective impairment, the Bank uses statistical modelling of historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgement as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical modelling.

1. Significant accounting policies (continued):

Impairment losses on assets carried at amortized cost are measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the asset's original effective interest rate. Impairment losses are recognized in profit or loss and reflected in an allowance account against loans and advances. Interest on impaired assets continues to be recognized through the unwinding of the discount. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

The Bank would write off certain loans and advances if and when they are determined to be uncollectible.

(b) Cash and cash equivalents:

Cash and cash equivalents include notes and coins on hand, unrestricted balances held with banks and highly liquid financial assets with original maturities of less than three months, which are subject to insignificant risk of changes in their fair value, and are used by the Bank in the management of its short-term commitments.

Cash and cash equivalents are carried at amortized cost in the statement of financial position.

(c) Loans and advances:

Policy applicable from January 1, 2018:

'Loans and advances' captions in the statement of financial position include only loans and advances measured at amortized cost; they are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortized cost using the effective interest method;

Policy applicable before January 1, 2018:

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and that the Bank does not intend to sell immediately or in the near term.

1. Significant accounting policies (continued):

Loans and advances are initially measured at fair value plus incremental direct transaction costs, and subsequently measured at their amortized cost using the effective interest method, except when the Bank chooses to carry the loans and advances at fair value through profit or loss.

(d) Acceptances:

Acceptances comprise undertakings by the Bank to pay bills of exchange drawn on customers. The Bank expects most acceptances to be settled simultaneously with the reimbursement from the customers. The Bank's potential liability under acceptances is reported as a liability in the statement of financial position. The Bank's recourse against the customer in the event of a call on any of these commitments is reported as an offsetting asset of the same amount. Fees earned are reported as other income.

(e) Office equipment and leasehold improvements:

(i) Recognition and measurement:

Office equipment and leasehold improvements represent items of property and equipment that are measured at cost less accumulated depreciation and accumulated impairment losses.

Cost includes expenditures that are directly attributable to the acquisition of the asset. Purchased software that is integral to the functionality of the related equipment is capitalized as part of that equipment.

When parts of an item of property or equipment have different useful lives, they are accounted for as separate items (major components) of property and equipment.

The gain or loss on disposal of an item of property and equipment is determined by comparing the proceeds from disposal with the carrying amount of the item of property and equipment, and are recognized, net within other income in profit or loss.

1. Significant accounting policies (continued):

(ii) Subsequent costs:

The cost of replacing a part of an item of property or equipment is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Bank and its cost can be measured reliably. The carrying amount of the replaced part is derecognized. The costs of the day-to-day servicing of property and equipment are recognized in profit or loss as incurred.

(iii) Depreciation:

Depreciation is recognized in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property and equipment since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset.

The estimated useful lives for the current and comparative years are as follows:

IT equipment	4 years
Fixtures and fittings	4 - 7 years
Automobile	5 years

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

1. Significant accounting policies (continued):

(f) Foreign currency transactions:

Transactions in foreign currencies are translated into Canadian dollars at the spot exchange rate at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated into the functional currency at the spot exchange rate at that date. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated into the functional currency at the spot exchange rate at the date that the fair value was determined. Foreign currency differences arising on retranslation are recognized in profit or loss. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

Transactions in foreign currencies are translated into Canadian dollars at the spot exchange rate at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated into the functional currency at the spot exchange rate at that date. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated into the functional currency at the spot exchange rate at the date that the fair value was determined. Foreign currency differences arising on retranslation are recognized in profit or loss. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

(g) Impairment of non-financial assets:

The carrying amounts of the Bank's non-financial assets, other than deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated.

The recoverable amount of an asset is the greater of its value in use and its fair value less costs to sell.

An impairment loss is recognized if the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognized in profit or loss.

1. Significant accounting policies (continued):

(h) Deposits:

Deposits are the Bank's main sources of debt funding. Deposits are initially measured at fair value minus incremental direct transaction costs, and subsequently measured at their amortized cost using the effective interest method, except where the Bank chooses to carry the liabilities at fair value through profit or loss.

(i) Provisions:

A provision is recognized if, as a result of a past event, the Bank 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 and, where appropriate, the risks specific to the liability.

A provision for restructuring is recognized when the Bank has approved a detailed and formal restructuring plan, and the restructuring either has commenced or has been announced publicly. Future operating losses are not provided for.

(j) Financial guarantees and loan commitments:

'Financial guarantees' are contracts that require the Bank to make specified payments to reimburse the holder for a loss that it incurs because a specified debtor fails to make payment when it is due in accordance with the terms of a debt instrument. 'Loan commitments' are firm commitments to provide credit under pre-specified terms and conditions.

1. **Significant accounting policies (continued):**

Financial guarantees issued or commitments to provide a loan at a below-market interest rate are initially measured at fair value. Subsequently, they are measured as follows:

- from January 1, 2018: at the higher of the loss allowance determined in accordance with IFRS 9 and the amount initially recognized less, when appropriate, the cumulative amount of income recognized in accordance with the principles of IFRS 15; and

- before January 1, 2018: at the higher of the amount representing the initial fair value amortized over the life of the guarantee or the commitment and the present value of any expected payment to settle the liability when a payment under the contract has become probable.

The Bank has issued no loan commitments. Liabilities arising from financial guarantees are included within provisions.

(k) Employee benefits - defined contribution plans:

A defined contribution plan is a post-employment benefit plan under which an entity pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans are recognized as an expense in profit or loss when they are due in respect of service rendered before the end of the reporting year. Prepaid contributions are recognized as an asset to the extent that a cash refund or a reduction in future payments is available. Contributions to a defined contribution plan that are due more than 12 months after the end of the reporting year in which the employees render the service are discounted to their present value at the reporting date.

(l) Income tax expense:

Income tax expense comprises current and deferred taxes. Current tax and deferred tax are recognized in profit or loss, except to the extent that it relates to items recognized directly in equity or in other comprehensive income.

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.

1. Significant accounting policies (continued):

Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities against current tax assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

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 that it is no longer probable that the related tax benefit will be realized.

Additional income taxes that arise from the distribution of dividends by the Bank are recognized at the same time as the liability to pay the related dividend is recognized.

(m) Lease payments:

Payments made under operating leases are recognized in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognized as an integral part of the total lease expense, over the term of the lease.

1. Significant accounting policies (continued):

(n) Derivative instruments:

Derivatives are financial instruments whose value derives largely from the price, price fluctuations and price expectations of an underlying instrument (e.g., share, bond, foreign exchange or index). Derivatives may include swaps, options and futures.

Derivative contracts used by the Bank include forward contracts. In the normal course of business, the Bank enters into derivative transactions for trading and/or risk management purposes. The Bank's objectives in using derivative instruments are to meet customers' risk management needs to manage the Bank's exposure to risks.

In accordance with the Bank's accounting policy relating to derivatives, all derivatives are carried at fair value in the statement of financial position regardless of whether they are held for trading or non-trading purposes.

(o) Interest income and expense:

Interest income and expense are recognized in profit or loss using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash 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, the Bank estimates future cash flows considering all contractual terms of the financial instrument, but not future credit losses.

The calculation of the effective interest rate includes all fees and points 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 liability.

Interest income and expense presented in the statement of comprehensive income include interest on financial assets and financial liabilities measured at amortized cost calculated on an effective interest basis.

Fair value changes on derivatives held for risk management purposes are presented in other income in the statement of comprehensive income.

1. Significant accounting policies (continued):

(p) Fees and commission:

Fees and commission income and expense that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

Other fees and commission income, including account servicing fees, investment management fees, sales commission, placement fees and syndication fees, are recognized as the related services are performed. When a loan commitment is not expected to result in the drawdown of a loan, the related loan commitment fees are recognized on a straight-line basis over the commitment period.

2. Changes in accounting policies:

A number of new standards and amendments to standards are effective for annual periods beginning after January 1, 2018 and earlier application is permitted; however, the Bank has not early adopted them in preparing these financial statements, with the exception of the amendment to IFRS 9 affecting prepayment features with negative.

IFRS 16, Leases ("IFRS 16"):

The Bank is required to adopt IFRS 16 Leases on January 1, 2019.

IFRS 16 introduces a single, on-balance sheet lease accounting model for lessees. A lessee recognizes a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. There are recognition exemptions for short-term leases and leases of low-value items. Lessor accounting remains similar to the current standard - i.e. lessors continue to classify leases as finance or operating leases.

The Bank has not yet finalized the impact the new standard will have on the financial statements.

3. Nature and extent of risk arising from financial instruments:

Risk management framework overview:

The primary goal of risk management at the Bank is to minimize risk. Risk is anything that will cause a desired objective not to be achieved. Risk, in varying degrees, is present in virtually all business activities of financial institutions and the Bank recognizes that it is an unavoidable consequence of doing business. The key objectives of the risk management process are to ensure that the outcome of risk-taking activities is within the Bank's risk tolerance, and that there is an appropriate balance between risk and reward. Accordingly, the Bank does not seek to avoid risk, but to manage it in a controlled manner commensurate with the expected reward.

The Board of Directors (the "Board") establishes a conservative culture with respect to the Bank's overall risk appetite. The Board has overall responsibility for risk management and reviews and approves risk management strategies, policies, standards and key limits. The Board ensures there are sufficient and qualified risk management resources across the Bank to meet the risk management objectives. The Board, directly or through its committees, the Audit Committee and Conduct Review and Risk Management Committee, receives regular updates on the key risks of the Bank.

Risks are managed by the senior management of the Bank within the policies and limits established by the Board. Senior management plays a key role in the risk management process and is responsible for implementation of the policies and establishing a control environment by developing processes to monitor and measure risk and ensure compliance with laws and regulations.

The Internal Audit of the Parent independently monitors and reports to senior management and the Board on the effectiveness of risk management policies, procedures and internal controls. The internal auditors have unrestricted access to the Bank's staff, information and records and to the Audit Committee. The Bank's enterprise risk framework and risk management processes are reviewed by the Internal Auditor annually.

There was no significant change in the risk management framework from the previous year.

3. Nature and extent of risk arising from financial instruments (continued):

The Bank is exposed to four major types of risk: credit, liquidity, market (all from its use of financial instruments) and operational as follows:

(a) Credit risk:

'Credit risk' is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Bank's loans and advances to customers and other banks, and investment debt securities.

The Bank manages credit risk through specific credit policies that are approved by the Board. These policies set out the procedures for identifying and measuring credit risk, evaluating and approving credit, ongoing monitoring and managing such risk.

The Bank created the Bank's Credit Committee for the oversight of credit risk. A separate Bank's Credit Function, reporting to the Bank's Credit Committee, is responsible for managing the Bank's credit risk, including the following.

- Implementation of credit policies, covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements.

- Adherence to the authorization structure set for the approval and renewal of credit facilities.

- Authorization limits are allocated to designated Senior Management Officers. Larger facilities require approval by the Bank Credit Committee, the Board of Directors, or the Parent Bank's Credit Committee, as appropriate.

- Reviewing and assessing credit risk: Bank Credit Function assesses all credit exposures in excess of designated limits, before facilities are committed to customers. Renewals and reviews of facilities are subject to the same review process.

- Limiting concentrations of exposure to counterparties, geographies and industries (for loans and advances, financial guarantees and similar exposures), and by issuer, credit rating band, market liquidity and country (for investment securities and banks), as appropriate.

3. Nature and extent of risk arising from financial instruments (continued):

- Developing and maintaining the Bank's risk gradings to categorize exposures according to the degree of risk of default.

- Maintaining of and adherence to the Bank's processes for measuring ECL: This includes processes for:

  – determining and monitoring significant increase in credit risk; and

  – incorporation of forward-looking information.

- Reviewing compliance with agreed exposure limits, including those for selected industries, country risk and product types as set by the Bank's credit policies. Regular reports on the credit quality of the portfolios are provided to Bank's Credit Committee, which may require appropriate corrective action to be taken. These include reports containing estimates of ECL allowances.

- Providing advice, guidance and specialist skills to promote best practice throughout the Bank in the management of credit risk.

The Bank's Credit Committee provided initial approval, regular validation and back-testing of the models used for measuring ECL.

The Credit Function is required to implement Bank credit policies and procedures, with credit approval authorities delegated from the Bank Credit Committee and Board of Directors. The Bank has a Senior Credit Risk Officer who reports on all credit-related matters to Senior management and the Bank Credit Committee. The Credit Function is responsible for the quality and performance of its credit portfolio and for monitoring and controlling all credit risks in its portfolios, including those subject to Parent Bank's Credit Committee approval.

Regular audits of Bank credit processes are undertaken by Internal Audit.

(In thousands of Canadian dollars)

3. Nature and extent of risk arising from financial instruments (continued):

(b) Liquidity risk:

Liquidity risk is the risk that the Bank is unable to meet its obligations when they fall due as a result of customer deposits being withdrawn, cash requirements from contractual commitments, or other cash outflows.

The Bank manages liquidity risk through specific policies that are approved by the Board. The Bank is conservative in its liquidity policy and constantly maintains a high level of liquidity by keeping substantial balances in liquid assets and in short-term interbank placements. To ensure that the Bank has sufficient liquid assets on hand, the key liquidity risk management tools include the use of an automated tool for measuring any mismatch in the liquidity positions to determine funding requirements, monitoring the level of core and large deposits, control of concentration limits, and the computation of liquidity requirements under stressed conditions on a regular basis.

The tables below present the cash flows payable by the Bank under non-derivative financial liabilities and assets held for managing liquidity risk by remaining contractual maturities at the date of the statement of financial position. The amounts disclosed in the tables are the contractual undiscounted cash flow.

2018	Up to 1 month	1 - 3 months	3 months to 1 year	Over 1 year	No specific maturity	Total
Assets						
Cash resources	$ 58,342	$ 1,404	$ 831	$ –	$ (22)	$ 60,555
Government of Canada treasury bill	9,960	–	–	–	–	9,960
Loans	20,284	9,438	27,791	96,146	(1,236)	152,423
Other	–	–	–	–	1,561	1,561
Total	88,586	10,842	28,622	96,146	303	224,499
Liabilities and Shareholder's Equity						
Liabilities:						
Deposits	121,257	11,849	23,173	33,271	–	189,550
Other	–	–	–	–	2,727	2,727
Shareholder's equity	–	–	–	–	32,222	32,222
Total	121,257	11,849	23,173	33,271	34,949	224,499
Total gap	$ (32,671)	$ (1,007)	$ 5,449	$ 62,875	$ (34,646)	$ –

(In thousands of Canadian dollars)

3. Nature and extent of risk arising from financial instruments (continued):

2017	Up to 1 month	1 - 3 months	3 months to 1 year	Over 1 year	No specific maturity	Total
Assets						
Cash resources	$ 61,006	$ 168	$ –	$ –	$ –	$ 61,174
Government of Canada treasury bill	9,968	–	–	–	–	9,968
Loans	20,617	11,086	12,543	85,696	–	129,942
Allowance for impairment	–	–	–	–	(1,597)	(1,597)
Other	–	–	–	–	2,440	2,440
Total	91,591	11,254	12,543	85,696	843	201,927
Liabilities and Shareholder's Equity						
Liabilities:						
Deposits	109,453	10,383	25,171	23,530	–	168,537
Other	–	–	–	–	2,256	2,256
Shareholder's equity	–	–	–	–	31,134	31,134
Total	109,453	10,383	25,171	23,530	33,390	201,927
Total gap	$ (17,862)	$ 871	$ (12,628)	$ 62,166	$ (32,547)	$ –

(c) Market risk:

Market risk is a risk of loss due to changes in interest and foreign currency rates. The Bank manages these risks through specific policies that are approved by the Board.

Interest rate risk arises from the impact that changes in interest rates may have on income due to the mismatch between variable rate asset and liability positions. The Bank does a maturity mapping for liquidity and a scenario analysis for interest rate risk, whereby the impact of certain predefined interest rate movements within each maturity bracket are analyzed and compared to a benchmark.

Foreign currency risk is the risk of loss due to changes in foreign exchange rates. Foreign exchange activities are customer-related and the Bank does not execute foreign exchange transactions on its own account, except to hedge or cover open positions.

3. Nature and extent of risk arising from financial instruments (continued):

(d) Operational risk:

Operational risk is the risk of loss resulting from external events, human error or from inadequate or failed internal processes and systems.

The Bank has established policies that have been approved by the Board to manage and control this risk. Operations and the handling of day-to-day risks are the responsibility of management. In this regard, detailed operating procedures have been developed with built-in checks and balances.

(e) Capital management:

Regulatory capital for the Bank is regulated pursuant to guidelines issued by the Office of the OSFI. Beginning in 2013, OSFI's regulatory capital guidelines under Basel III allow for two tiers of capital. The Bank's CET1 capital includes common shares, retained earnings and accumulated other comprehensive income. The Bank currently does not hold any additional Tier 1 or Tier 2 capital instruments. Therefore, the Bank's CET1 is equal to its Tier 1 and Total regulatory capital, and are calculated and reported under IFRSs.

Regulatory ratios are calculated by dividing CET1, Tier 1 and Total capital by risk-weighted assets ("RWA"). The calculation of RWA is determined by OSFI-prescribed rules relating to on-balance sheet and off-balance sheet exposures and included an amount for the market risk exposure associated with trading portfolios. In addition, OSFI formally established risk-based capital targets for deposit-taking institutions: a target CET1 ratio of 7% and a target Total capital ratio of 10.5%.

In accordance with OSFI "Leverage Requirements Guideline" (2014), the leverage ratio is defined as Tier 1 capital divided by leverage ratio exposure. The leverage ratio exposure is the sum of (i) on-balance sheet exposures; (ii) derivative exposures; (iii) securities financing transaction exposures; and (iv) off-balance sheet items. Canadian banks are required to maintain a leverage ratio that meets or exceeds a minimum leverage ratio level prescribed by OSFI at all times.

The Bank's CET1, Tier 1 and Total capital and ratios for the year ended December 31, 2018 and comparative information for the prior year have been calculated using Basel III (Standardized Approach). The Bank has complied with all regulatory-imposed capital requirements at year end.

3. Nature and extent of risk arising from financial instruments (continued):

(f) Internal Capital Adequacy Assessment Process:

In October 2010, OSFI issued a Guideline E-19, Internal Capital Adequacy Assessment Process ("ICAAP") for Deposit-Taking Institutions, to outline their expectations with respect to an institution's internal capital adequacy process, as described in Part 3 of the Basel II Framework. It is OSFI's expectation that every federally regulated financial institution ("FRFI"), including Canadian subsidiaries of foreign banks, will put into place an ICAAP that covers the operations from the top level regulated entity in Canada. In all instances, the ICAAP should reflect the FRFI's own circumstances, and not just those of a related group.

The Bank developed its own detailed ICAAP document in accordance with OSFI expectations that covers the following six main components:

(i) Board and senior management oversight;

(ii) Sound capital assessment and planning;

(iii) Comprehensive assessment of risks;

(iv) Stress testing;

(v) Monitoring and reporting; and

(vi) Internal control review.

4. Exposure to credit risk:

As at the financial statement date, all financial assets measured at amortized cost, with the exception of loans and advances, are due to be settled within the short term. The Bank considers the probability of default to be close to zero as these instruments have a low frequency of default and the counterparties are expected to have the capacity to meet their contractual obligations in the near term.

(In thousands of Canadian dollars)

4. Exposure to credit risk (continued):

An analysis of the Bank's loans and advances to customers, by category and concentration by location of ultimate risk, is as follows:

	2018	2017
Loans and advances at amortized cost:		
Canada:		
Commercial mortgages	$ 65,619	$ 50,835
Residential mortgages	44,798	40,586
Business loans	31,697	24,578
Personal loans	293	2,573
	142,407	118,572
Other:		
Residential mortgages	1,520	1,574
Business loans	9,732	9,796
	11,252	11,370
Total loans	153,659	129,942
Allowance for credit losses	1,236	1,597
Total net loans	$ 152,423	$ 128,345

As at December 31, 2018, total loans and advances include $11,832 (2017 - $12,741) denominated in foreign currencies.

(In thousands of Canadian dollars)

4. Exposure to credit risk (continued):

The following tables presents the gross carrying amounts of loans and advances subject to IFRS 9 impairment requirements by internal risk rating categories used by the Bank for credit risk management purposes. The internal risk rating categories presented in the table below are defined as follows:

Satisfactory (*internal risk ratings 1 - 6*): Loan and advances that exceed the credit risk profile standard of the Bank with an average or below average probability of default and are typical for the Bank's risk appetite, credit standards and retain a typical or below average probability of default. These loans and advances are expected to have average or lower than the average yields and would represent a significant percentage of the overall portfolio.

Especially mentioned (*internal risk ratings 7 - 9*): Loan and advances within the Bank's risk appetite and credit standards that have an additional element of credit risk that could result in an above average probability of default. These loan and advances carry a yield premium in return for their incremental credit risk. These loans and advances are expected to represent a small percentage of the overall portfolio.

Substandard (*internal risk ratings 10*): Loan and advances that are not within the Bank's risk appetite and credit standards and that have an additional element of credit risk that could result in high probability (close to default) of default. These loans and advances are expected to represent a small percentage of the overall portfolio.

Doubtful and Loss (*internal risk ratings D1 and D2*): Loan and advances that are 90 days past due and when there is objective evidence that there has been a deterioration of credit quality to the extent the Bank no longer has reasonable assurance as to the timely collection of the full amount of principal and interest and/or when the Bank has commenced enforcement remedies available to it under its contractual agreements.

Commercial mortgages	Stage 1	Stage 2	Stage 3	Total
Satisfactory (ratings 1 - 6)	$ 60,852	$ –	$ –	$ 60,852
Especially mentioned (ratings 7 - 9)	–	–	–	–
Substandard (rating 10)	–	–	922	922
Doubtful and loss (rating D1 and D2)	–	–	3,845	3,845
Gross carrying amount	60,852	–	4,767	65,619
ECL allowance	(174)	–	(700)	(874)
Net carrying amount, December 31, 2018	$ 60,678	$ –	$ 4,067	$ 64,745

(In thousands of Canadian dollars)

4. Exposure to credit risk (continued):

Residential mortgages	Stage 1	Stage 2	Stage 3	Total
Satisfactory (ratings 1 - 6)	$ 46,318	$ –	$ –	$ 46,318
Especially mentioned (ratings 7 - 9)	–	–	–	–
Substandard (rating 10)	–	–	–	–
Doubtful and loss (rating D1 and D2)	–	–	–	–
Gross carrying amount	46,318	–	–	46,318
ECL allowance	(54)	–	–	(54)
Net carrying amount, December 31, 2018	$ 46,264	$ –	$ –	$ 46,264

Business loans	Stage 1	Stage 2	Stage 3	Total
Satisfactory (ratings 1 - 6)	$ 39,860	$ –	$ –	$ 39,860
Especially mentioned (ratings 7 - 9)	419	–	–	419
Substandard (rating 10)	–	–	1,150	1,150
Doubtful and loss (rating D1 and D2)	–	–	–	–
Gross carrying amount	40,279	–	1,150	41,429
ECL allowance	(305)	–	–	(305)
Net carrying amount, December 31, 2018	$ 39,974	$ –	$ 1,150	$ 41,124

Personal loans	Stage 1	Stage 2	Stage 3	Total
Satisfactory (ratings 1 - 6)	$ 293	$ –	$ –	$ 293
Especially mentioned (ratings 7 - 9)	–	–	–	–
Substandard (rating 10)	–	–	–	–
Doubtful and loss (rating D1 and D2)	–	–	–	–
Gross carrying amount	293	–	–	293
ECL allowance	(3)	–	–	(3)
Net carrying amount, December 31, 2018	$ 290	$ –	$ –	$ 290

(In thousands of Canadian dollars)

4. Exposure to credit risk (continued):

The following table show the continuity and credit migration of the principal balances of the Bank's loans and advances at amortized cost during the year:

Commercial mortgages	Stage 1	Stage 2	Stage 3	Total
Gross carrying amount, January 1, 2018	$ 47,736	$ –	$ 3,099	$ 50,835
Mortgages issued, net of repayments	14,605	–	705	15,310
Transfers in (out) to:				
Stage 1	(963)	–	–	(963)
Stage 2	–	–	–	–
Stage 3	–	–	963	963
Changes to models and inputs used for ECL calculation	(526)	–	–	(526)
Write-offs	–	–	–	–
Recoveries	–	–	–	–
Gross carrying amount, December 31, 2018	$ 60,852	$ –	$ 4,767	$ 65,619

Residential mortgages	Stage 1	Stage 2	Stage 3	Total
Gross carrying amount, January 1, 2018	$ 42,160	$ –	$ –	$ 42,160
Mortgages issued, net of repayments	3,290	–	–	3,290
Transfers in (out) to:				
Stage 1	–	–	–	–
Stage 2	–	–	–	–
Stage 3	–	–	–	–
Changes to models and inputs used for ECL calculation	868	–	–	868
Write-offs	–	–	–	–
Recoveries	–	–	–	–
Gross carrying amount, December 31, 2018	$ 46,318	$ –	$ –	$ 46,318

(In thousands of Canadian dollars)

4. Exposure to credit risk (continued):

Business loans	Stage 1	Stage 2	Stage 3	Total
Gross carrying amount, January 1, 2018	$ 33,791	$ –	$ 583	$ 34,374
Loans issued, net of repayments	8,791	–	(658)	8,133
Transfers in (out) to:				
Stage 1	(1,225)	–	–	(1,225)
Stage 2	–	–	–	–
Stage 3		–	1,225	1,225
Changes to models and inputs used for ECL calculation	(1,078)	–	-	(1,078)
Write-offs	–	–	–	–
Recoveries	–	–	–	–
Gross carrying amount, December 31, 2018	$ 40,279	$ –	$ 1,150	$ 41,429

Personal loans	Stage 1	Stage 2	Stage 3	Total
Gross carrying amount, January 1, 2018	$ 2,573	$ –	$ -	$ 2,573
Loans issued, net of repayments	(2,240)	–	–	(2,240)
Transfers in (out) to:				
Stage 1	–	–	–	–
Stage 2	–	–	–	–
Stage 3		–	–	–
Changes to models and inputs used for ECL calculation	(40)	–	-	(40)
Write-offs	–	–	–	–
Recoveries	–	–	–	–
Gross carrying amount, December 31, 2018	$ 293	$ –	$ –	$ 293

(In thousands of Canadian dollars)

4. Exposure to credit risk (continued):

An analysis of the Bank's exposure to credit risk by sector and classes of financial instruments is as follows:

					2018	2017
	At amortized cost			At FVTPL		
	Outstanding	Undrawn commitments	Other[1]	Over-the-counter ("OTC") derivatives[2]	Total exposure[3]	Total exposure[3]
Personal						
Residential mortgages	$ 46,317	$ 3,368	$ –	$ –	$ 49,685	$ 47,143
Personal loans	291	41	–	–	332	3,319
Total	46,608	3,409	–	–	50,017	50,462
Business						
Steel wholesale	15,313	1,436	–	–	16,749	11,676
Real estate	77,933	410	4,042	–	82,385	53,122
Clothing and textile wholesale	3,917	1,662	69	8	5,656	6,245
Hospitality and lodging	3,978	–	–	–	3,978	9,467
Other	5,910	2,293	619	–	8,822	15,819
Total	107,051	5,801	4,730	8	117,590	96,329
Total exposure	$ 153,659	$ 9,210	$ 4,730	$ 8	$ 167,607	$ 146,791

[1]Includes contingent liabilities, such as letters of credit and guarantees.

[2]Includes foreign exchange forward replacement values.

[3]Total exposure represents gross exposure upon the default of an obligor. This amount is before allowance for credit losses and does not reflect the impact of credit risk mitigation.

(In thousands of Canadian dollars)

4. Exposure to credit risk (continued):

Collateral and other security enhancements:

The Bank holds collateral against business and personal loans in the form of mortgage interest over property, other security over assets, and guarantees. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and generally are not updated, except when a loan is renewed or individually assessed as impaired. An estimate of the fair value of collateral and other security enhancements held against business and personal loans is shown below:

	Loan outstanding		Collateral security	
	2018	2017	2018	2017
Property	$ 135,282	$ 109,756	$ 275,135	$ 220,332
Cash and term deposits	4,067	4,611	4,068	4,611
Other	13,567	14,570	13,567	14,570
Unsecured	743	1,005	–	–
Total	$ 153,659	$ 129,942	$ 292,770	$ 239,513

5. Past due and impaired assets and allowance for impairment:

(a) At December 31, 2018, the Bank had individually impaired loans of $5,917 (2017 - $3,690). As at December 31, 2018, the Bank had past due loans of $5,917 (2017 - $3,682).

(b) Key sources of estimation uncertainty in determining the allowances for credit losses:

Upon adoption of IFRS 9 on January 1, 2018, all loans that are contractually 90 days in arrears are classified as impaired and in Stage 3. Under IAS 39, the evaluation of impairment was generally the same.

Assets accounted for at amortized cost are evaluated for impairment on a basis described in accounting policy (note 1).

The components of the Stage 3 allowance for credit losses are evaluated individually and are based upon management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash inflows, management makes judgements about a counterparty's financial situation and the net realizable value of any underlying collateral. Each impaired asset is assessed on its merits, workout strategy and estimate of cash flows considered recoverable.

(In thousands of Canadian dollars)

5. Past due and impaired assets and allowance for impairment (continued):

(c) The Bank's allowance for credit losses at initial application of IFRS 9:

The following table is a comparison of impairment allowances determined in accordance with IAS 39 to the corresponding impairment allowance determined in accordance with IFRS 9 as at January 1, 2018, where financial assets are classified as amortized cost under IAS 39 and IFRS 9 with no respective impact due to classification and measurement.

	IAS 39 as at December 31, 2017				IFRS 9 as at January 1, 2018			
	Collectively Assessed	Individually Assessed	Total	Transition adjustments	Stage 1	Stage 2	State 3	Total
Commercial mortgages	$ 409	$ 700	$ 1,109	$ (272)	$ 137	$ –	$ 700	$ 837
Residential mortgages	225	–	225	(103)	122	–	–	122
Business loans	247	–	247	1	248	–	–	248
Personal loans	16	–	16	2	18	–	–	18
Interest-bearing deposits with banks	3	–	3	14	17	–	–	17
Government of Canada treasury bill	–	–	–	–	–	–	–	–
Financial guarantees		–	–	–	–	–	–	–
Total allowance for credit losses	$ 900	$ 700	$ 1,600	$ (358)	$ 542	$ –	$ 700	$ 1,242

5. Past due and impaired assets and allowance for impairment (continued):

The following table presents adjustments made to Retained earnings due to initial application of IFRS 9:

Total allowance for credit losses as at December 31, 2017	$ 1,600
Total allowance for credit losses as at January 1, 2018	1,242
Transition adjustments	358
Tax effect	(95)
Adjustment on initial application of IFRS 9, net of tax, as at January 1, 2018	$ 263

The following tables provide a reconciliation of the opening balance to the closing balance of the allowance for credit losses under IFRS 9, during the year. The reconciling items shown below comprise the following components:

- net originations, which reflects both the increase in the allowance related to financial assets originated during the year, and the decrease in the allowance related to financial assets derecognized during the year that did not incur a credit loss;
- transfers between stages, which are assumed to occur prior to any corresponding remeasurement of the allowance;
- the impact of changes to the models and inputs used to calculate the ECL, including those related to modifications of forward-looking indicators, which include macroeconomic conditions;
- write-offs of financial assets deemed uncollectible; and
- recoveries.

(In thousands of Canadian dollars)

5. Past due and impaired assets and allowance for impairment (continued):

				2018
Commercial mortgages	Stage 1	Stage 2	Stage 3	Total
ECL allowance, beginning of year	$ 137	$ –	$ 700	$ 837
Net originations	42	–	–	42
Transfers in (out) to:	–	–	–	–
Stage 1:	(3)	–	–	(3)
Stage 2:	–	–	–	–
Stage 3:	–	–	–	–
Changes to models and inputs used for ECL calculation:	(2)	–	–	(2)
Write-offs:	–	–	–	–
Recoveries:	–	–	–	–
ECL allowance, end of year	$ 174	$ –	$ 700	$ 874

				2018
Residential mortgages	Stage 1	Stage 2	Stage 3	Total
ECL allowance, beginning of year	$ 122	$ –	$ –	$ 122
Net originations	(4)	–	–	(4)
Transfers in (out) to:	–	–	–	–
Stage 1:	–	–	–	–
Stage 2:	–	–	–	–
Stage 3:	–	–	–	–
Changes to models and inputs used for ECL calculation:	(64)	–	–	(64)
Write-offs:	–	–	–	–
Recoveries:	–	–	–	–
ECL allowance, end of year	$ 54	$ –	$ –	$ 54

(In thousands of Canadian dollars)

5. Past due and impaired assets and allowance for impairment (continued):

				2018
Business loans	Stage 1	Stage 2	Stage 3	Total
ECL allowance, beginning of year	$ 248	$ –	$ –	$ 248
Net originations	69	–	–	69
Transfers in (out) to:	–	–	–	–
Stage 1:	(5)	–	–	(5)
Stage 2:	–	–	–	–
Stage 3:	–	–	–	–
Changes to models and inputs used for ECL calculation:	(7)	–	–	(7)
Write-offs:	–	–	–	–
Recoveries:	–	–	–	–
ECL allowance, end of year	$ 305	$ –	$ –	$ 305

				2018
Personal loans	Stage 1	Stage 2	Stage 3	Total
ECL allowance, beginning of year	$ 18	$ –	$ –	$ 18
Net originations	(15)	–	–	(15)
Transfers in (out) to:	–	–	–	–
Stage 1:	–	–	–	–
Stage 2:	–	–	–	–
Stage 3:	–	–	–	–
Changes to models and inputs used for ECL calculation:	–	–	–	–
Write-offs:	–	–	–	–
Recoveries:	–	–	–	–
ECL allowance, end of year	$ 3	$ –	$ –	$ 3

5. Past due and impaired assets and allowance for impairment (continued):

				2018
Interest-bearing deposits with banks	Stage 1	Stage 2	Stage 3	Total
ECL allowance, beginning of year	$ 17	$ –	$ –	$ 17
Net originations	(2)	–	–	(2)
Transfers in (out) to:	–	–	–	–
Stage 1:	–	–	–	–
Stage 2:	–	–	–	–
Stage 3:	–	–	–	–
Changes to models and inputs used for ECL calculation:	7	–	–	7
Write-offs:	–	–	–	–
Recoveries:	–	–	–	–
ECL allowance, end of year	$ 22	$ –	$ –	$ 22

				2018
Financial guarantees	Stage 1	Stage 2	Stage 3	Total
ECL allowance, beginning of year	$ –	$ –	$ –	$ –
Net originations	1	–	–	1
Transfers in (out) to:	–	–	–	–
Stage 1:	–	–	–	–
Stage 2:	–	–	–	–
Stage 3:	–	–	–	–
Changes to models and inputs used for ECL calculation:	4	–	–	4
Write-offs:	–	–	–	–
Recoveries:	–	–	–	–
ECL allowance, end of year	$ 5	$ –	$ –	$ 5

(In thousands of Canadian dollars)

5. Past due and impaired assets and allowance for impairment (continued):

An analysis of the IFRS 9 allowance for impairment by financial assets category is as follows:

	IFRS 9 as at January 1, 2018				IFRS 9 as at December 31, 2018			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	State 3	Total
Commercial mortgages	$ 137	$ –	$ 700	$ 837	$ 174	$ –	$ 700	$ 874
Residential mortgages	122	–	–	122	54	–	–	54
Business loans	248	–	–	248	305	–	–	305
Personal loans	18	–	–	18	3	–	–	3
Interest-bearing deposits with banks	17	–	–	17	22	–	–	22
Government of Canada treasury bill	–	–	–	–	–	–	–	–
Financial guarantees	–	–	–	–	5	–	–	5
Total allowance for credit losses	$ 542	$ –	$ 700	$ 1,242	$ 563	$ –	$ 700	$ 1,263

(In thousands of Canadian dollars)

5. Past due and impaired assets and allowance for impairment (continued):

(d) Loans with renegotiated terms:

Loans with renegotiated terms are loans that have been restructured due to deterioration in the borrower's financial position and where the Bank has made concessions that it would not otherwise consider.

At December 31, 2018 and 2017, the Bank had no loans with renegotiated terms.

6. Office equipment and leasehold improvements:

			2018	2017
	Cost	Accumulated depreciation	Net book value	Net book value
Office equipment and leasehold improvements	$ 2,435	$ 1,742	$ 693	$ 1,007

Depreciation for the year amounted to $353 (2017 - $342).

(In thousands of Canadian dollars)

6. Office equipment and leasehold improvements (continued):

	Office equipment	Leasehold improvements	Total
Cost			
Balance, January 1, 2017	$ 1,473	$ 708	$ 2,181
Acquisitions	157	58	215
Balance, December 31, 2017	$ 1,630	$ 766	$ 2,396
Balance, January 1, 2018	$ 1,630	$ 766	$ 2,396
Acquisitions	32	7	39
Balance, December 31, 2018	$ 1,662	$ 773	$ 2,435
Depreciation and impairment losses			
Balance, January 1, 2017	$ 639	$ 407	$ 1,046
Depreciation	262	81	343
Balance, December 31, 2017	$ 901	$ 488	$ 1,389
Balance, January 1, 2018	$ 901	$ 488	$ 1,389
Depreciation	269	84	353
Balance, December 31, 2018	$ 1,170	$ 572	$ 1,742
Carrying amounts			
Balance, December 31, 2017	$ 729	$ 278	$ 1,007
Balance, December 31, 2018	492	201	693

The Bank has no capitalized borrowing costs related to the acquisition of equipment or related to internal development. The Bank has no intangible assets.

(In thousands of Canadian dollars)

7. Deposits:

The following is an analysis of the Bank's deposits by category:

	Payable on demand	Payable after notice	Payable on fixed date	2018 Total	2017 Total
Individuals	$ 35,239	$ 3,861	$ 41,381	$ 80,481	$ 77,258
Businesses	43,257	–	43,737	86,994	80,492
Deposit-taking institutions	6,813	–	15,262	22,075	10,787
Total deposits	$ 85,309	$ 3,861	$ 100,380	$ 189,550	$ 168,537

As at December 31, 2018, total deposits include $47,907 (2017 - $46,569) denominated in foreign currencies.

8. Income taxes:

(a) Income tax expense:

	2018	2017
Current tax expense	$ 236	$ 14
Deferred tax expense	64	30
Total income tax expense	$ 300	$ 44

Reconciliation of effective tax rate:

	2018	2017
Income before income taxes	$ 1,125	$ 200
Income tax using the statutory tax rate of 26.5% (2017 - 26.5%)	$ 298	$ 53
Non-deductible expenses	2	2
Change in unrecognized deferred tax assets	–	(25)
Other	–	14
Total income tax expense	$ 300	$ 44

(In thousands of Canadian dollars)

8. Income taxes (continued):

(b) Deferred tax assets and liabilities:

Recognized deferred tax assets and liabilities:

Deferred tax assets are attributable to the following:

	2018	2017
Non-capital loss carry forwards	$ –	$ 133
Office equipment and leasehold improvements	(15)	(38)
Allowance for impairment	168	257
Deferred income	65	25
	$ 218	$ 377

9. Segmented information:

(a) An analysis of the Bank's aggregate outstanding interest-bearing deposits with banks, loans and acceptances by geographic segment, on the basis of the location of ultimate risk, is as follows:

	2018	2017
Canada	$ 204,459	$ 185,651
United Kingdom	2,661	4,544
United States	6,339	7,120
Other	9,046	2,075
Total	$ 222,505	$ 199,390

(b) Total interest income, based on country of residence of the borrower, is as follows:

	2018	2017
Canada	$ 8,056	$ 5,746
United Kingdom	7	5
United States	34	30
Other	65	74
Total	$ 8,162	$ 5,855

10. Related party transactions:

In the normal course of business, the Bank enters into transactions with its key management personnel (directors and officers and their interests), the Parent and companies under common control.

As at December 31, 2018, deposits payable to the Bank's Parent and companies under common control amounted to $21,838 (2017 - $10,686) and deposits receivable amounted to $2,712 (2017 - $4,591). Interest of $ 250 (2017 - $47) was paid to the Bank's Parent and companies under common control in respect of deposits payable, and interest of $7 (2017 - $5) was received in respect of deposits receivable. Interest rates paid on deposits from related parties were at the rates that would be charged in an arm's-length transaction.

The Bank has loans to directors and officers and their interests in the amount of $1,406 as at December 31, 2018 (2017 - $1,525). The mortgages and secured loans granted are secured over property of the respective borrowers. Interest of $63 (2017 - $58) was received in respect to these loans. Interest rates charged on balances outstanding from related parties were at the rates that would be charged in an arm's-length transaction. No impairment losses have been recorded against balances outstanding during the year with key management personnel, and no specific allowance has been made for impairment losses on balances with key management personnel and their immediate relatives at year end.

Management fees of $736 (2017 - $650) were paid by the Bank to its Parent.

Key management personnel compensation for the year was $1,365 (2017 - $1,333). This includes all short- and long-term wages and benefits, including directors' fees and the amount allocated to the Bank by the Parent.

11. Commitments and contingent liabilities:

Credit commitments:

In the normal course of business, the Bank enters into various commitments to meet the credit requirements of its customers.

Such commitments at December 31, 2018 include:

(a) $4,730 (2017 - $5,291) for financial guarantees, documentary and commercial letters of credit and standby letters of credit, which require the Bank to honour drafts presented by third parties upon completion of specific activities or make payments where the customer is unable to meet financial obligations. In the event of a call on these commitments, the Bank has recourse against its customers; and

(b) $9,210 (2017 - $11,539) for commitments to extend credit, which represent undertakings to make credit available in the form of loans or other financings, subject to certain conditions.

(In thousands of Canadian dollars)

12. Interest rate sensitivity:

The following table summarizes statement of financial position assets, liabilities and shareholder's equity to arrive at the Bank's interest rate gap based on the earlier of contractual repricing and maturity dates:

	Floating rate	Within 3 months	3 months to 1 year	1 - 5 years	Non-rate sensitive	2018 Total	2017 Total
Assets							
Cash resources	$ 43,136	$ 8,499	$ –	$ –	$ 8,920	$ 60,555	$ 61,174
	1.92%	2.33%	–	–	–	1.70%	1.06%
Government of Canada	–	–	9,960	–	–	9,960	9,968
treasury bill	–	–	1.75%	–	–	1.75%	1.10%
Loans and advances	150,044	1,447	74	2,092	2	153,659	129,942
	5.14%	2.14%	4.50%	3.92%	–	5.10%	4.40%
Allowance for impairment		–	–	–	(1,236)	(1,236)	(1,597)
Other		–	–	–	1,561	1,561	2,440
Total	193,180	9,946	10,034	2,092	9,247	224,499	201,927
Liabilities and Shareholder's Equity							
Liabilities:							
Deposits	3,861	44,788	22,758	32,834	85,309	189,550	168,537
	1.14%	2.14%	1.65%	3.25%	–	1.29%	0.75%
Other	–	–	–	–	2,727	2,727	2,256
	3,861	44,788	22,758	32,834	88,036	192,277	170,793
Shareholder's equity	–	–	–	–	32,222	32,222	31,134
Total	3,861	44,788	22,758	32,834	120,258	224,499	201,927
Total gap	$ 189,319	$ (34,842)	$ (12,724)	$ (30,742)	$ (111,011)	$ –	$ –

(In thousands of Canadian dollars)

12. Interest rate sensitivity (continued):

As at December 31, 2018, a one-percentage-point change in the market interest rate over a one-year period would have an impact of approximately $ 970 on net interest income over the next year.

13. Fair values of financial instruments:

The amounts set out in the table below represent the fair values of the Bank's on-balance sheet financial instruments using the valuation method and assumptions described below. The amounts do not include the fair value of underlying assets and liabilities that are not considered financial instruments, such as office equipment.

The estimated fair value amounts are designed to approximate amounts at which instruments could be exchanged in a current transaction between willing parties who are under no compulsion to act. However, many of the Bank's financial instruments lack an available trading market. Therefore, fair values are based on estimates using present value and other valuation techniques, which are significantly affected by the assumptions used concerning the amount and timing of estimated future cash flows and discount rates, which reflect varying degrees of risk. Because of the estimation process and the need to use judgement, the aggregate fair value amounts should not be interpreted as being necessarily realizable in an immediate settlement of the instruments.

			2018			2017
	Fair value	Carrying value	Fair value over carrying value	Fair value	Carrying value	Fair value over carrying value
Assets						
Cash resources	$ 70,515	$ 70,515	$ –	$ 71,142	$ 71,142	$ –
Loans and advances	152,423	152,423	–	128,345	128,345	–
Derivative assets	8	8	–	19	19	–
Other	860	860	–	1,414	1,414	–
Liabilities						
Deposits	189,550	189,550	–	168,537	168,537	–
Derivative liabilities	5	5	–	17	17	–
Other	2,722	2,722	–	2,239	2,239	–

13. Fair values of financial instruments (continued):

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

Due to their short-term nature, the carrying values of certain on-balance sheet financial instruments are assumed to approximate their fair values. These financial instruments include cash resources, other assets, deposits and other liabilities.

The Bank follows a fair value hierarchy to categorize the inputs used to measure fair value of financial instruments shown in the table below. The fair value hierarchy is based on quoted prices in active markets (Level 1), models using inputs other than quoted prices (Level 2), or models using inputs that are not based on observable market data (Level 3).

Fair values of financial instruments:

	Derivative assets		Derivative liabilities	
	2018	2017	2018	2017
Valued using internal models (with observable inputs)	$ 8	$ 19	$ 5	$ 17

14. Derivative financial instruments:

All of the Bank's derivative contracts are OTC foreign exchange forward transactions that are privately negotiated between the Bank and the counterparty to the contract.

Foreign exchange forwards are contracts in which one party contracts with another to exchange a specified amount of one currency for a specified amount of a second currency at a future date or range of dates.

All derivative instruments were originated in Canada with maturities of six months or less.

The Bank does not engage in other types of derivative products.

(In thousands of Canadian dollars)

14. Derivative financial instruments (continued):

The tables below provide an analysis of the Bank's derivative portfolio and related credit exposure:

(a) Fair value of derivative financial instruments:

	2018		2017	
	Favourable	Unfavourable	Favourable	Unfavourable
Foreign exchange forward contracts	$ 8	$ 5	$ 19	$ 17

(b) Notional principal and credit exposure:

	Foreign exchange forward contracts	
	2018	2017
Notional amount	$ 940	$ 2,280
Current replacement cost	8	19
Credit risk equivalent	18	41
Risk-weighted balance	14	21

The notional amount is not recorded as an asset or liability as it represents the face amount of the contract to which a rate or price is applied to determine the amount of cash flows to be exchanged. Notional principal amounts do not represent the potential gain or loss associated with market risk and are not indicative of the credit risk associated with derivative financial instruments.

Current replacement cost represents the cost of replacing all contracts that have a favourable fair value, using current market rates. It represents in effect the unrealized gains on the Bank's derivative instruments. Replacement cost disclosed in the table above represents the net amount of the asset and liability to a specific counterparty where the Bank has a legally enforceable right to offset the amount owed to the Bank with the amount owed by the Bank and the Bank intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

(In thousands of Canadian dollars)

14. Derivative financial instruments (continued):

Credit risk equivalent represents the total replacement cost plus an amount representing the potential future credit exposure, as outlined in the Capital Adequacy Guideline of the Superintendent.

Risk-weighted balance represents the credit risk equivalent, weighted based on the creditworthiness of the counterparty, as prescribed by OSFI.

15. Capital position:

The table below provides a summary of the regulatory capital and ratios for the year ended December 31, 2018 and comparative information for the prior year. The Bank is in compliance with the imposed capital requirements to which it is subject:

	2018	2017
Capital structure and ratios:		
CET1 capital:		
Common shares	$ 30,000	$ 30,000
Retained earnings	2,222	1,134
CET1 capital	32,222	31,134
Tier 1 capital	32,222	31,134
Total (eligible) capital	32,222	31,134
Risk-weighted assets	156,065	128,471
Capital ratios:		
CET1 Ratio	20.65%	24.23%
Tier 1 Ratio	20.65%	24.23%
Total Ratio	20.65%	24.23%
Leverage ratio exposure	$ 230,830	$ 207,971
Leverage ratio	13.96%	14.97%

16. Employee benefit plans:

The Bank has a defined contribution pension plan for eligible employees. Current service pension costs are expensed as funded. The total pension expense for the year was $159 (2017 - $157).