HomeEquity Bank™

BASEL III PILLAR 3 DISCLOSURES

December 31, 2023

Overview

HomeEquity Bank (the "Bank") is a federally regulated Schedule I bank, incorporated and domiciled in Canada. The Bank is a wholly owned subsidiary of HOMEQ Corporation (HOMEQ). On November 30, 2012, under an arrangement agreement, Birch Hill Equity Partners Management Inc. acquired all the outstanding common shares of HOMEQ and became the ultimate parent of the group. On September 30, 2022, Ontario Teachers' Pension Plan Board (OTPP) indirectly acquired all of the outstanding shares of HOMEQ and became the ultimate parent of the group.

The Bank's main business is to originate and administer reverse mortgages. The Bank also issues guaranteed investment certificates and through its principal subsidiary, senior medium-term debt (MTN) to fund its mortgage portfolio.

Basis of preparation

This document represents the Basel III Pillar 3 disclosures for the Bank. These disclosures are made pursuant to the Office of the Superintendent of Financial Institutions (OSFI) requirements, which are based on global standards established by the Bank of International Settlements, Basel Committee on Banking Supervision (BCBS). The Bank follows the Pillar 3 Disclosure requirements for Small and Medium-Sized Banks (SMSBs) and is classified as a Category 2 SMSB.

The amounts disclosed in this document are based on the Bank's annual audited consolidated financial statements, which reflect the financial position and results of operations of the Bank consolidated with the financial position and results of operations of its subsidiaries. These consolidated financial statements are prepared in accordance with IFRS Accounting Standards as issued by the International Accounting Standards Board (IASB), including the accounting requirements specified by OSFI, and reflect, where necessary, management's best estimates and judgments.

This report is unaudited and is reported in thousands of Canadian dollars, unless otherwise noted.

The report is available in the Regulatory section of the Bank's website at www.homeequitybank.ca, and on OSFI's Financial Data for Banks website (Financial data - Office of the Superintendent of Financial Institutions (osfi-bsif.gc.ca)).

KM1: Key Metrics (at consolidated group level)

		Dec 31, 2023	Sep 30, 2023	Jun 30, 2023	Mar 31, 2023	Dec 31, 2022
	Available capital (amounts)					
1	Common Equity Tier 1 (CET1)	508,241	474,108	466,329	453,557	443,271
2	Tier 1	508,241	474,108	466,329	453,557	443,271
3	Total capital	543,133	507,799	489,971	474,409	458,414
	Risk-weighted assets (amounts)					
4	Total risk-weighted assets (RWA)	3,112,160	2,942,251	2,817,325	3,358,233	3,215,259
	Risk-based capital ratios as a percentage of RWA					
5	CET1 ratio (%)	16.3%	16.1%	16.6%	13.5%	13.7%
6	Tier 1 ratio (%)	16.3%	16.1%	16.6%	13.5%	13.7%
7	Total capital ratio (%)	17.5%	17.3%	17.4%	14.1%	14.3%
	Additional CET1 buffer requirements as a percentage of RWA					
8	Capital conservation buffer requirement (2.5% from 2019) (%)	2.5%	2.5%	2.5%	2.5%	2.5%
9	Countercyclical buffer requirement (%)	n/a	n/a	n/a	n/a	n/a
10	Bank G-SIB and/or D-SIB additional requirements (%)	n/a	n/a	n/a	n/a	n/a
11	Total of bank CET1 specific buffer requirements (%) (row 8 + row 9 + row 10)	2.5%	2.5%	2.5%	2.5%	2.5%
12	CET1 available after meeting the bank's minimum capital requirements (%)	9.3%	9.1%	9.6%	6.5%	6.7%
	Basel III Leverage ratio					
13	Total Basel III leverage ratio exposure measure	7,852,523	7,450,275	7,129,294	6,883,794	6,640,041
14	Basel III leverage ratio (row 2 / row 13)	6.47%	6.36%	6.54%	6.59%	6.65%

CC1: Composition of capital for SMSBs

(in thousands of Canadian dollars)		**Dec 31, 2023**
	Common Equity Tier 1 capital: instruments and reserves	
1	Directly issued qualifying common share capital (and equivalent for non-joint stock companies) plus related stock surplus	200,163
2	Retained earnings	310,277
6	**Common Equity Tier 1 capital before regulatory adjustments**	510,440
	Common Equity Tier 1 capital: regulatory adjustments	
28	Total regulatory adjustments to Common Equity Tier 1	(2,199)
29	Common Equity Tier 1 capital (CET1)	508,241
	Additional Tier 1 capital: regulatory adjustments	
44	**Additional Tier 1 capital (AT1)**	0
45	**Tier 1 capital (T1 = CET1 + AT1)**	508,241
	Tier 2 capital: instruments and provisions	
50	Eligible Stage 1 and Stage 2 allowance	34,892
51	**Tier 2 capital before regulatory adjustments**	34,892
	Tier 2 capital: regulatory adjustments	
57	**Total regulatory adjustments to Tier 2 capital**	
58	**Tier 2 capital (T2)**	34,892
59	**Total capital (TC = T1 + T2)**	543,133
60	**Total risk weighted assets**	3,112,160
	Capital ratios	
61	Common Equity Tier 1 (as a percentage of risk weighted assets)	16.3%
62	Tier 1 (as a percentage of risk weighted assets)	16.3%
63	Total capital (as a percentage of risk weighted assets)	17.5%
	OSFI target	
69	Common Equity Tier 1 capital target ratio	7.0%
70	Tier 1 capital target ratio	8.5%
71	Total capital target ratio	10.5%

LR2: Leverage Ratio Common Disclosure Template

	(in thousands of Canadian dollars)	Dec 31, 2023	Sep 30, 2023
	On-balance sheet exposures		
1	On-balance sheet items (excluding derivatives, SFTs and grandfathered securitization exposures but including collateral)	7,738,747	7,337,677
2	Gross-up for derivatives collateral provided where deducted from balance sheet assets pursuant to the operative accounting framework (IFRS)		
3	(Deductions of receivable assets for cash variation margin provided in derivatives transactions)		
4	(Asset amounts deducted in determining Tier 1 capital)	(2,199)	(2,055)
5	**Total on-balance sheet exposures (excluding derivatives and SFTs) (sum of lines 1 to 4)**	7,736,548	7,335,622
	Derivative exposures		
6	Replacement cost associated with all derivative transactions		
7	Add-on amounts for PFE associated with all derivative transactions	508	610
8	(Exempted CCP-leg of client cleared trade exposures)		
9	Adjusted effective notional amount of written credit derivatives		
10	(Adjusted effective notional offsets and add-on deductions for written credit derivatives)		
11	**Total derivative exposures (sum of lines 6 to 10)**	508	610
	Other off-balance sheet exposures		
17	Off-balance sheet exposure at gross notional amount	288,668	285,108
18	(Adjustments for conversion to credit equivalent amounts)	(173,201)	(171,065)
19	**Off-balance sheet items (sum of lines 17 and 18)**	115,467	114,043
	Capital and total exposures		
20	**Tier 1 Capital**	508,241	474,108
21	**Total Exposures (sum of lines 5, 11, 16 and 19)**	7,852,523	7,450,275
	Leverage ratio		
22	**Basel III leverage ratio**	6.47%	6.36%

Credit Risk

Credit risk is the potential for financial loss if a borrower or counterparty in a transaction fails to meet its obligations in accordance with agreed terms. The Bank's maximum exposure to non-derivative credit risk is represented by its consolidated balance sheet's values for cash resources, securities, residential reverse mortgages, and other assets. Credit risk on the Bank's cash and deposits with banks is mitigated by maintaining cash balances at Schedule I Canadian chartered banks with high credit rating.

The Bank performs regular monitoring of its risks, assessments, and related action plans. Senior management and the Board of Directors obtain information that allows them to keep informed regarding the effectiveness of their risk management process and activities. The Bank has a Conduct Review and Risk Management Committee (CRRMC) to assist the Board in fulfilling its responsibilities. The CRRMC monitors and approves credit risk initiatives that align with the Bank's strategy and risk appetite and/or recommends to the Board for approval.

CRA: General qualitative information about credit risk

CRA (a): How the business model translates into the components of the Bank's credit risk profile.

The Bank's main business is to originate and administer reverse mortgages. Underwriting risk on the mortgage loans is mitigated by following Board-approved underwriting policies. During the underwriting process, every property is appraised. The initial appraised value is subsequently discounted, typically by between 5% and 30%.

CRA (b): Criteria and approach used for defining credit risk management policy and for setting credit risk limits.

The Board has charged the CRRMC to ensure each reverse mortgage approved by the Bank is within the RAF, meets the Board established credit standards, is collateralized per Bank requirements and is valid and enforceable. The Bank must comply with the concentration limits set in the policy and must report them to the CRRMC and/or the Board. The concentration limits are based on Property Location, Property Type. The Bank's credit risk management principles are based on the identification and quantification of risk, continuous monitoring, and reporting of key credit risk measures.

CRA (c): Structure and organization of the credit risk management and control function.

The Board approved credit risk appetite is supported by the establishment of risk approval authorities and risk limits, which are delegated by the Board to the senior management team. To facilitate day-to-day activities, the senior management team has delegated some of their authorities onward to others in the organization. Exceptions are reported to the CRRMC and the board as per the approved credit risk policy for review and providing effective oversight.

CRA (d): Relationships between the credit risk management, risk control, compliance and internal audit functions.

The Bank has established the three lines of defense model which is predicated on OSFI's three-lines-of-defense approach and is fundamental to the banks Policy governance and operating structure. The first line of defense is responsible for identification, assessment, mitigation, and reporting of credit risk. The second line of defense owns the Enterprise Risk Management Framework, oversees risk management practices and performs independent challenge, analysis, and reporting as required. The internal audit function provides independent and objective assurance by performing audits of the Bank's adherence with the Credit Policy based on Board-approved audit cycles and reporting audit results to the Audit Committee and Bank Management.

CRA (e): Scope and main content of the reporting on credit risk exposure and on the credit risk management function to the executive management and to the Board of Directors.

The senior management team, CRRMC and the Board receive regular reporting on credit risk, including, portfolio composition and quality, portfolio performance including geographical spread and LTV % breakdown, adherence to risk appetite, material changes to risk strategy, as well as any other relevant metrics to monitor material risks as required.

ORA: General qualitative information on a Bank's operational risk framework

ORA (a): The Bank's policies, frameworks and guidelines for the management of operational risk.

The Bank's Operational Risk Management Policy and the Operational Risk Management Framework (ORMF) are integral to the Bank's Enterprise Risk Management Framework and is aligned with the Board-approved Risk Assessment Framework (RAF). The ORMF is risk-based and establishes the foundation for consistent identification and assessment, independent review, and monitoring and reporting of operational risks across the Bank.

ORA (b): The structure and organisation of the Bank's operational risk management and control function.

The ORMF governance structure has three lines of defence to safeguard the Bank against operational risk. The first line of defence from operational risk is at the transaction level where the Bank's business units are responsible for ensuring that appropriate internal controls are in place and operating effectively. The Bank also has a Risk and Compliance Department (second line of defence) which serves as independent challenge to the business units and whose function is to identify key operational risks that the Bank is exposed to and independently validate the effectiveness of the Bank's operational internal controls. The Bank also has an Internal Audit function (third line of defence) which audits the Bank using a risk-based approach.

ORA (c): The Bank's operational risk measurement system (i.e. the systems and data used to measure operational risk in order to estimate the operational risk capital charge).

The Bank uses the simplified standardized approach to measure operational risk in its calculation of risk-weighted assets. As such, the Bank holds capital for operational risk equal to 15% of average annual Adjusted Gross Income over the previous 12 fiscal quarters.

ORA (d): The scope and main context of the Bank's reporting framework on operational risk to executive management and to the Board of Directors.

Senior management is responsible for identifying risks and developing risk management policies. The Board, both directly or through its committees, reviews and approves Bank policies, and implements specific reporting procedures to enable it to monitor the Bank's risk profile and ensure compliance with the Board-approved RAF.

ORA (e): The risk mitigation and risk transfer used in the management of operational risk. This includes mitigation by policy (such as the policies on risk culture, risk appetite, and outsourcing), by divesting from high-risk businesses, and by the establishment of controls. The remaining exposure can then be absorbed by the bank or transferred. For instance, the impact of operational losses can be mitigated with insurance.

The Bank mitigates its operational risk by implementing policies and procedures directed at identified risks, employing knowledgeable and experienced senior managers, segregating duties among employees, training all employees with respect to effective risk management, and continually reviewing and upgrading the policies, procedures and controls that form the Bank’s ORMF. Effective risk management plays an essential role in the Bank's ability to meet its financial targets and remain financially sound.