Haventree Bank

BASEL III PILLAR 3 DISCLOSURES

SEPTEMBER 30, 2018

1. Nature of operations

Haventree Bank (the “Bank”), formerly Equity Financial Trust Company ("EFT"), is a federally regulated financial institution and a wholly owned subsidiary of Equity Financial Holdings Inc. (“EQI”). Effective June 11, 2018, regulatory approval from the Office of the Superintendent of Financial Institutions Canada ("OSFI") and the Minster of Finance, Canada was granted to continue EFT as a Schedule I Bank under the Bank Act (Canada) as Haventree Bank. The Bank serves the Canadian mortgage market by offering residential first and second mortgage loans to customers who are seeking an alternative mortgage solution because they do not meet the conventional underwriting standards of the major Canadian banks. The Bank is domiciled in Canada, with its registered office located at 100 King Street West, Suite 4610, Toronto, Ontario.

2. Capital

The Bank’s Capital Management Policy governs the quantity and quality of its capital, ensuring it meets minimum regulatory capital requirements, is consistent with the Bank’s risk appetite framework, and supports the Bank’s strategic objectives. Management’s internal capital adequacy assessment process is integral to the Bank’s capital planning activities and incorporates a stress testing program that evaluates the impact of potential scenarios on income and capital. Regulatory capital requirements addressed by the policy include the leverage ratio and risk-based capital ratios (Common Equity Tier 1 (“CET 1”), Tier 1 and Total Capital).

Regulatory capital and capital ratios calculations are based on the Capital Adequacy Requirements Guidelines issued by OSFI. The guidelines are based on Basel III: A global regulatory framework for more resilient banks and banking systems – A Revised Framework (“Basel III”).

The leverage ratio is currently defined as Tier 1 capital divided by the total exposure measure. The exposure measure is the sum of: (a) on-balance sheet exposures; (b) derivative exposures; (c) securities financing transaction exposures; and (d) off-balance sheet items. Federally regulated deposit-taking institutions are expected to have Basel III leverage ratios that meet or exceed 3%. In addition, OSFI has established leverage ratio targets on a confidential and institution by institution basis. The Bank’s capital, capital and leverage ratios are disclosed below in Table 1 and Table 2.

Table 1: Regulatory Capital

		As at	
($000s, except percentage amounts)		**September 30, 2018**	December 31, 2017
Common Equity Tier 1 capital: Instruments and reserves	**Line No.**	**All-in**	All-in
Directly issues qualifying common share capital plus related stock surpluses	1	**$ 55,560**	$ 36,056
Retained earnings	2	**67,382**	59,316
Accumulated other comprehensive loss	3	**(879)**	(453)
Common Equity Tier 1 capital before regulatory adjustments	6	**122,063**	94,919
Common Equity Tier 1 capital: Regulatory adjustments			
Total regulatory adjustments to Common Equity Tier 1	28	**(3,996)**	(3,647)
Common Equity Tier 1 capital (CET1)	29	**118,067**	91,272
Tier 1 capital	45	**118,067**	91,272
Total capital	59	**118,067**	91,272
Total risk-weighted assets	60	**604,988**	468,540
Capital ratios			
Common Equity Tier 1 (as percentage of risk-weighted assets)	61	**19.5%**	19.5%
Tier 1 (as percentage of risk-weighted assets)	62	**19.5%**	19.5%
Total capital (as percentage of risk-weighted assets)	63	**19.5%**	19.5%
OSFI all-in target			
Common Equity Tier 1 capital all-in target ratio	69	**7.0%**	7.0%
Tier 1 capital all-in target ratio	70	**8.5%**	8.5%
Total capital all-in target ratio	71	**10.5%**	10.5%

Note: Line item numbers reference the Pillar III Modified Capital Disclosure Requirements issued by OSFI.

Table 2: Leverage Ratio

($000s, except percentage amounts)	Line No.	As at September 30, 2018	As at December 31, 2017
On-balance sheet exposures			
On-balance sheet items	1	**$ 1,574,502**	$ 1,237,626
Asset amounts deducted in determining Basel III "all-in" Tier 1 capital	2	**(3,996)**	(3,647)
Total on-balance sheet exposure	3	**1,570,506**	1,233,979
Derivative exposures			
Replacement cost	4	**-**	-
Add-on amounts for potential future exposure	5	**239**	193
Total derivatives exposure	11	**239**	193
Other off-balance sheet exposures			
Off-balance sheet exposure at gross notional amount	17	**197,288**	174,385
Adjustment for conversion to credit equivalent amounts	18	**150,830**	139,508
Off-balance sheet items	19	**39,458**	34,877
Tier 1 capital	20	**118,067**	91,272
Total exposures	21	**1,610,203**	1,269,049
Basel III leverage ratio	22	**7.3%**	7.2%

Note: Line item numbers reference the Basel III Leverage Ratio Framework and Disclosure Requirements issued by OSFI.

3. Credit Risk

Credit risk is the risk of loss resulting from the failure of a borrower or counterparty to honour its financial or contractual obligations. The nature of the Bank's mortgage lending operations creates an exposure to credit risk resulting from possible defaults in payment by borrowers. The Bank oversees the management of credit risk through its Enterprise Risk Management Committee ("ERMC"), which is comprised of members of senior management. The ERMC meets regularly to review risk factors in the mortgage portfolio and periodically considers and recommends adjustments to the credit risk limits in the Board approved credit lending policy.

As part of the underwriting process, the Bank relies heavily upon information supplied by both borrowers and third parties. If any of this information is intentionally or negligently misrepresented and the misrepresentation is not detected before completing the transaction, the credit risk associated with the transaction may be increased. If house prices increase at a faster rate than incomes, fewer borrowers will be able to qualify for mortgage financing at their desired level. In addition, some borrowers may be tempted to overstate their incomes to meet lender credit and debt service requirements. While underwriting, risk and compliance policies and procedures are in place to monitor and manage credit risk, there can be no absolute assurances to prevent credit risk from having an adverse effect on the Bank's profitability and financial condition.

The mortgage portfolio consists of uninsured residential mortgages. As a result, the Bank's primary credit risk relates to the potential for financial loss resulting from the failure of a borrower to fully honour their financial or contractual obligations, such as the failure to repay principal and/or interest on the mortgage. The portfolio consists of residential mortgages originated under lending programs designed to serve customers who are seeking an alternative solution because they have limited access to traditional financing. There is a higher risk of default associated with these customers than with traditional borrowers. The typical customer includes borrowers with a thin or challenged credit history or who are self employed. Because the Bank serves customers who are unable to meet the conventional underwriting standards of the major Canadian banks, interest is charged at higher rates than those lenders. The factors used in determining borrowers' creditworthiness may be subject to change over time. An increase in loan losses beyond those expected and provided for could have a material adverse effect on the Bank's operating results and financial condition. The Bank mitigates this risk primarily by conducting diligence on each borrower and by dealing with known and reputable mortgage brokers. In addition, as an uninsured residential mortgage lender, credit risk also results from reliance on the maintenance of collateral values. The Bank is therefore selective in the types of property accepted as collateral, the reliance on the appraisal of the property, and its geographic location.

Although subject to change with Board approval, the Bank predominantly lends to borrowers in urban and suburban areas of Ontario. Although these lending areas are among Canada's largest housing markets, a significant economic shock to the regional economy could have a disproportionately adverse impact on the mortgage portfolio, in light of the general economic conditions and credit risks discussed above, compared to the impact for a lender with a more regionally or nationally diversified mortgage portfolio. The Bank established lending operations in the Western provinces during the second quarter of 2018. The Western lending operations are also focused on urban and suburban areas of British Columbia, Alberta, Saskatchewan and Manitoba, which over time will provide for a more geographically diversified portfolio.

4. Liquidity Risk

Liquidity risk is defined as the possibility the Bank will be unable to generate or maintain sufficient cash or cash equivalents, in a timely manner, to meet its commitments as they become due.

Managing liquidity risk requires management to maintain sufficient liquid assets on hand at all times to pay cash obligations, in a timely manner, such as maturing deposits and deposit interest, new mortgage commitments, accounts payables, accrued liabilities and other business obligations.

The Bank has established a liquidity management framework which includes the following:

- A Board-approved policy that quantifies the Bank's liquidity risk tolerance and minimum liquidity requirements;
- A monitoring and risk control framework that forecasts cash inflows and outflows and contractual liquidity commitments for short and long-term horizons;
- Requirements for the diversification of funding sources;
- The maintenance of a liquidity reserve consisting of cash and cash equivalents and high-liquid quality assets ("HQLA");
- Daily reporting that measures compliance with Board-approved limits;
- Periodic stress testing of liquidity assumptions and forecasts, which may include company-specific liquidity shocks, exogenous systemic disruptions, or combinations of both; and
- A liquidity contingency plan that considers several scenarios according to which the Bank's liquidity operations could be disrupted and details what actions will be followed under each scenario.

The Asset-Liability Committee ("ALCO") is comprised of members of senior management and is charged with monitoring the Bank's liquidity exposures. ALCO periodically reviews liquidity policies and procedures as appropriate to evolving business requirements and makes recommendations for policy amendments to the Board as required.

ALCO also reviews the results of periodic stress tests and may direct management to temporarily alter its liquidity strategy accordingly.

The Bank's Board has established minimum liquidity requirement limits using two measures required under Basel III and included in OSFI's Liquidity Adequacy Requirements Guideline ("LARG"):

- Liquidity Coverage Ratio ("LCR"): the ratio of the Bank's HQLA reserve to net cash inflows and outflows for a specified time horizon; and
- Net Stable Funding Ratio ("NSFR"): the ratio of the Bank's liabilities to assets adjusted by factors that represent their inherent stability or permanence, which will become effective in 2019.

These requirements are supplemented by additional supervisory monitoring metrics including the OSFI-designed Net Cumulative Cash Flow ("NCCF").

The appropriateness of these limits is reviewed from time to time by ALCO in light of prevailing and anticipated business conditions.

5. Interest rate risk

Interest rate risk is defined as the possibility that changes in market interest rates will adversely affect the Bank's profitability and financial condition. Interest rate risk may be affected if an unduly large proportion of assets or liabilities have unmatched terms, interest rates or other attributes. The primary method of managing interest rate risk involves matching asset and liability maturity profiles, closely monitoring interest rates and acting upon any mismatch in a timely manner to ensure that any sudden or prolonged change in interest rates does not adversely affect net interest income. Any failure to appropriately match asset and liability maturity profiles could negatively impact operating results and financial condition of the Bank. From time to time, the Bank enters into derivative transactions to hedge interest rate risk. Where appropriate, hedge accounting is applied to minimize volatility in reported earnings from interest rate changes. All derivative contracts are over-the-counter contracts with highly rated Canadian financial institutions. The use of derivative products is governed by a Board-approved policy that permits the use of derivatives for the purpose of hedging asset-liability mismatches.

6. Market risk

Market risk is the exposure to adverse changes in the value of financial assets. Market risk factors include price risk on available-for-sale securities. The Bank mitigates this risk by investing only in high-quality, liquid assets guaranteed by the Government of Canada, its provinces or municipalities and actively monitoring investments.

7. Remuneration

Compensation Process

The Board of Directors has overall responsibility for determining and implementing the Bank's philosophy with respect to executive compensation. The Governance and Compensation Committee ("GCC") is responsible for the establishment and oversight of the compensation of the senior management team, including, the Chief Executive Officer ("CEO"), Chief Financial Officer, Chief Risk Officer, Vice President, Mortgage Operations, Vice President, Mortgage Servicing (commencing 2018) and the Vice President, Sales & Marketing. This includes setting or reviewing the objectives of and reviewing performance under compensation, benefits and perquisites program for the senior management team. The GCC establishes performance criteria, evaluates performance and sets compensation for the CEO. Decisions regarding the compensation of other executive officers (including other senior management) are made by the CEO in consultation with the GCC.

In this regard, the CEO provides the GCC with evaluations of executive performance, business goals and objectives and recommendations regarding salary levels, bonuses and equity awards. Due to the size of the Bank and the lack of direct comparables, the Bank did not use formal benchmarking in determining executive compensation, but used available market information of comparably-sized financial services organizations when considered appropriate.

Compensation Philosophy and Objectives

The Bank's compensation program is designed to attract, motivate, reward and retain the personnel required to achieve business goals and objectives. In doing so, the Bank focuses on total compensation rather than individual elements of pay and the same compensation philosophy applies to all employees, including management, executive and senior officers. The senior management team was compensated through a mix of base salary, annual incentive bonus, options and benefits.

Compensation Related Risks

The GCC recognizes that certain elements of compensation could promote unintended or inappropriate risk-taking behaviours. The GCC has sought to minimize the Bank's risk exposure by ensuring that an executive compensation package is comprised of a mix of cash and equity compensation, balancing short-term incentives (i.e. cash bonuses) and long-term incentives (i.e. option grants). This helps ensure that executive performance is better aligned with the interests of the Bank. The GCC has continued this risk management and oversight process in respect of compensation through the ongoing review and identification of relevant risks in respect of the Bank's compensation practices and the maintenance of an active dialogue between management, the Board of Directors and the GCC in respect of the implementation of policies and practices to mitigate such risks.

Executive compensation risk management is reinforced by ongoing oversight by the Board of Directors of, among other things, the Bank's financial results, regulatory disclosures, strategic plans, fraud and error reporting, the Audit Committee's regular meetings with the external auditors (including without the presence of management), the Bank's internal controls, management information systems, and financial control systems.

Components of Executive Compensation

Compensation consists of three main elements: base salary, short-term variable compensation incentives (cash bonus) and long-term incentives (stock options). The percentage of each element of compensation is aligned with the individual's responsibility and ability to influence business results. The incentive opportunity varies with the performance and level of responsibility and is established annually by the Board of Directors for the CEO, and by the CEO for the other senior management team with the approval of the Board of Directors.

Details of the main elements of senior management compensation are:

1) Base Salary – Base salary provides a fixed level of income based on the individual's demonstrated ability to perform the role, the market value for the role and also having regard to the individual's responsibilities, years of service, potential for advancement and the assessment of the GCC. Base salary for the CEO is reviewed by the GCC and approved by the Board of Directors. Base salaries for the other executives are reviewed by the CEO and the GCC and approved by the Board of Directors.

2) Short-Term Variable Compensation Incentives

   The Board of Directors believes that a substantial portion of the compensation paid to the senior management should be at risk, contingent on achieving measurable operating results and metrics and personal performance. Annual non-equity performance-based awards are paid in cash following the completion of the audit of year-end financial results based upon satisfaction of individual, business unit, corporate financial and operational goals. The short-term incentive program will only pay out if certain minimum corporate financial targets are met.

The Board of Directors, on the recommendation of the GCC, set the variable compensation award targets based on the achievement of specific annual performance objectives that supported the operating, profitability and strategic goals of the Bank. Performance goals were set by the Board of Directors based on the business plan, business strategies and objectives related to building value for the Bank (for instance, size of the mortgage loan book and net income).

The GCC, on the approval of the Board of Directors, sets variable compensation targets for the CEO annually at the start of the financial year and recommends to the Board of Directors the variable compensation to be paid to the CEO following the end of the financial year upon approval of the audited financial statements. In turn, the CEO, with the approval of the GCC and the Board of Directors, sets variable compensation targets annually at the start of the financial year and determines the variable compensation to be paid to the other senior management upon approval of the audited annual financial statements.

3) Long-Term Incentives

In order to give employees a long-term incentive, the Bank adopted the Stock Option Plan under which options to acquire common shares are awarded. Options are granted by the Board of Directors on the recommendation of the CEO and the GCC to provide long-term incentives to members of senior management and key staff members. To ensure consistency, senior management awards were based on established levels of grants which vary depending on the individual's position.

During the year ended December 31, 2017, four meetings were held by the GCC committee and remuneration of $33,750 was paid to its members.

For the year ended December 31, 2017, the total amount of all salaries, bonuses and long-term incentives and other remuneration for the senior management team whose actions have a material impact on the risk exposure was:

					Non-Equity Incentive Plan Compensation				
Fiscal Year	Number of Staff	Salary ($000)	Share Based Awards ($000)	Option Based Awards ($000)	Annual Incentive Plans ($000)	Long Term Incentive Plans	Pension Value	All Other Compensation ($000)	Total Compensation ($000)
2017	7	1,507	147	503	847	Nil	Nil	247	3,251