



**Haventree
Bank**

BASEL III PILLAR 3 DISCLOSURES

MARCH 31, 2020

1. Nature of operations

Haventree Bank (the “Bank”), a Schedule 1 Bank, is a federally regulated financial institution and a wholly owned subsidiary of Haventree Holdings Inc (“HHI”). The Bank serves the Canadian mortgage market by offering residential 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 ratio calculations are based on the Capital Adequacy Requirements Guidelines issued by the Office of the Superintendent of Financial Institutions (“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.

OSFI has introduced capital flexibility measures to support COVID-19 efforts while promoting financial resilience and stability to institutions. The Bank has applied the transitional arrangements for regulatory capital treatment of expected credit loss (“ECL”) accounting by applying a scaling factor on the increase in Stage 1 and Stage 2 allowances relative to the amount of Stage 1 and Stage 2 allowances as at December 31, 2019. This increased amount is adjusted for tax effects and subject to a scaling factor that will decrease over time. The scaling factor to be applied is 70% for 2020, 50% for 2021 and 25% for 2022.

Table 1: Regulatory Capital

		As at	
(\$000s, except percentage amounts)		March 31, 2020	December 31, 2019
	Line No.	All-in	All-in
Common Equity Tier 1 capital: Instruments and reserves			
Directly issued qualifying common share capital plus related stock surpluses	1	\$ 64,048	\$ 64,054
Retained earnings	2	92,545	88,749
Accumulated other comprehensive income		915	171
Common Equity Tier 1 capital before regulatory adjustments	6	157,508	152,974
Common Equity Tier 1 capital: Regulatory adjustments			
Total regulatory adjustments to Common Equity Tier 1	28	(3,537)	(4,367)
Common Equity Tier 1 capital (CET1)	29	153,971	148,607
Common Equity Tier 1 capital with transitional arrangements for ECL provisioning not applied	29a	153,230	N/A
Tier 1 capital	45	153,971	148,607
Tier 1 capital with transitional arrangements for ECL provisioning not applied	45a	152,230	N/A
Total capital	59	153,971	148,607
Total capital with transitional arrangements for ECL provisioning not applied	59a	152,230	N/A
Total risk-weighted assets	60	818,187	783,706
Capital ratios			
Common Equity Tier 1 (as percentage of risk-weighted assets)	61	18.8%	19.0%
Common Equity Tier 1 with transitional arrangements for ECL provisioning not applied	61a	18.7%	N/A
Tier 1 (as percentage of risk-weighted assets)	62	18.8%	19.0%
Tier 1 ratio with transitional arrangements for ECL provisioning not applied	62a	18.7%	N/A
Total capital (as percentage of risk-weighted assets)	63	18.8%	19.0%
Total capital ratio with transitional arrangements for ECL provisioning not applied	63a	18.7%	N/A
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	
		March 31, 2020	December 31, 2019
On-balance sheet exposures			
On-balance sheet items	1	\$ 2,117,658	\$ 2,017,960
Asset amounts deducted in determining Basel III "all-in" Tier 1 capital	4	(3,537)	(4,367)
Total on-balance sheet exposure	5	2,114,121	2,013,593
Derivative exposures			
Replacement cost	6	2,784	224
Add-on amounts for potential future exposure	7	982	1,189
Total derivatives exposure	11	3,766	1,413
Other off-balance sheet exposures			
Off-balance sheet exposure at gross notional amount	17	209,653	127,951
Adjustment for conversion to credit equivalent amounts	18	(188,688)	115,155
Off-balance sheet items	19	20,965	12,796
Tier 1 capital	20	153,971	148,607
Tier 1 capital with transitional arrangements for ECL provisioning not applied	20a	153,230	N/A
Total exposures	21	2,138,852	2,027,802
Basel III leverage ratio	22	7.2%	7.3%
Basel III leverage ratio with transitional arrangements for ECL provisioning not applied	22a	7.2%	N/A

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.

The Bank lends to borrowers in Ontario, British Columbia, Alberta, Manitoba, Saskatchewan and Nova Scotia. Lending operations outside of Ontario began in 2018 and as such, the geographic distribution of the Bank's lending portfolio does not yet reflect the long-term desired distribution based on population and adjusted for variations in geographic risk appetite. Although some of these lending areas are among Canada's largest housing markets, a significant economic shock to the regional economy in Ontario 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's credit risk has increased due to COVID-19 as a result of unstable incomes to service contractual mortgage obligations, the resultant increase in the number of borrower requests for temporary payment relief (payment deferral), the inability of appraisers to enter properties in order to complete a full traditional appraisal and a general softening in the residential real estate market. As a result, the Bank has increased its ECL allowance to account for this increase in credit risk.

During the quarter, the Bank experienced a significant increase in requests for payment deferrals. During a payment deferral, the payments are skipped while interest is accrued on the outstanding balance of the mortgage. When granting payment deferrals, the Bank reviews the credit worthiness of the customer including repayment history and loan-to-value capacity. Payment deferrals are granted for up to six months to qualifying customers, consistent with the industry. The utilization of a payment deferral program, aimed at addressing the adverse economic impact of COVID-19, does not automatically result in a significant increase in credit risk ("SICR") or trigger an indication that there is no reasonable recovery of the loan, all things being equal. The Bank assesses changes in the risk of default occurring over the total expected life of an exposure. Loans subject to a payment deferral are not considered in default and do not result in loan modification.

As at March 31, 2020, the Bank has granted payment deferrals for 351 customers amounting to \$0.6 million in deferred loan payments, with a combined loan balance of \$137.1 million. Subsequent to quarter end, as at April 30, 2020, the Bank has granted payment deferrals for 1,202 customers amounting to \$3.0 million in deferred loan payments, with a combined loan balance of \$457.5 million.

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 measures required under Basel III or 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 Cumulative Cash Flow ("NCCF"): a metric that helps identify gaps between contractual inflows and outflows for various time bands over and up to a 12-month time horizon.

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

In response to volatility in financial markets and the economic disruptions caused by the shut-downs, the Bank has built its liquidity reserve well above normal operating levels to increase resiliency should any disruptions occur in the GIC deposit market. The GIC market is the Bank's primary source of funds for future commitments and while prices are currently elevated, this market has remained relatively stable to date. The Bank does not offer demand deposits and has not experienced an increase in early redemption requests for its fixed term GIC deposits. Although a

significant portion of borrowers are expected to receive payment deferrals, this will not materially affect the Bank's liquidity position. The Bank plans to maintain a higher liquidity reserve while markets and economic forecasts remain volatile but does not forecast any issues meeting its current funding requirements

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 employs 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 debt 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 the 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 Human Resources Committee ("GHRC") is responsible for the establishment and oversight of the compensation of senior management including, the Chief Executive Officer ("CEO"), Chief Financial Officer, Chief Compliance Officer, Chief Risk Officer, Vice President, Finance, Vice President, Information Technology, Vice President, Internal Audit, Vice President, Mortgage Operations, Vice President, Mortgage Servicing and the Vice President, Sales & Marketing. This includes setting or reviewing the objectives of and reviewing performance under compensation, benefits and perquisites program for senior management. The GHRC establishes performance criteria, evaluates performance and sets compensation for the CEO.

In this regard, the CEO provides the GHRC 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 does not use formal benchmarking in determining executive compensation but does use 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, stock options and benefits.

Compensation Related Risks

The GHRC recognizes that certain elements of compensation could promote unintended or inappropriate risk-taking behaviours. The GHRC 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 aligned with the interests of the Bank. The GHRC 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 GHRC 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 members of senior management 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 GHRC. Base salary for the CEO is reviewed by the GHRC and approved by the Board of Directors. Base salaries for the other executives are reviewed by the CEO and the GHRC 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 GHRC, set the variable compensation award targets based on the achievement of specific annual performance objectives that support the operating, profitability and strategic goals of the Bank. Performance goals are 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 GHRC, 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 GHRC 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 GHRC to provide long-term incentives to members of senior management. To ensure consistency, senior management awards are based on established targets which vary depending on the individual's position and the achievement of a set of long-term objectives established by the CEO and the Board of Directors that support the execution of the long-term strategy of the Bank.