HOME CAPITAL GROUP INC.
CELEBRATING 25 YEARS

# ANOTHER YEAR OF OUTSTANDING PERFORMANCE

ANNUAL REPORT 2011

# Financial Highlights

*Summary of Data for 10 Year Review*

| For the years ended December 31 (000s except per share amounts) | | 2011 | 2010 IFRS | 2010 GAAP | 2009 |
|---|---|---|---|---|---|
| Total assets | $ | **17,696,471** | 15,518,818 | 7,712,239 | 7,360,874 |
| Loans | $ | **16,060,208** | 14,062,602 | 5,832,569 | 5,440,747 |
| Securitized residential mortgages | $ | **8,243,350** | 8,116,636 | – | – |
| Deposits | $ | **7,922,124** | 6,595,979 | 6,522,850 | 6,409,822 |
| Shareholders' equity | $ | **774,785** | 628,585 | 742,280 | 590,288 |
| Mortgage-backed security assets under administration | $ | **–** | – | 8,166,533 | 4,147,711 |
| Revenue | $ | **790,591** | 687,249 | 533,937 | 489,179 |
| Net income | $ | **190,080** | 154,752 | 180,944 | 144,493 |
| Book value of common shares | $ | **22.38** | 18.14 | 21.42 | 17.00 |
| Earnings per share – basic | $ | **5.48** | 4.46 | 5.21 | 4.19 |
| Earnings per share – fully diluted | $ | **5.46** | 4.45 | 5.20 | 4.15 |

In 2011, Home Capital Group Inc. implemented International Financial Reporting Standards (IFRS) with a transition date of January 1, 2010. Figures for 2010 have been restated on an IFRS basis. Figures for 2009 and prior years are on a former Canadian Generally Accepted Accounting Principles (GAAP) basis.

**Adjusted* return on equity** was 27.4%, exceeding 20% for the 14th consecutive year

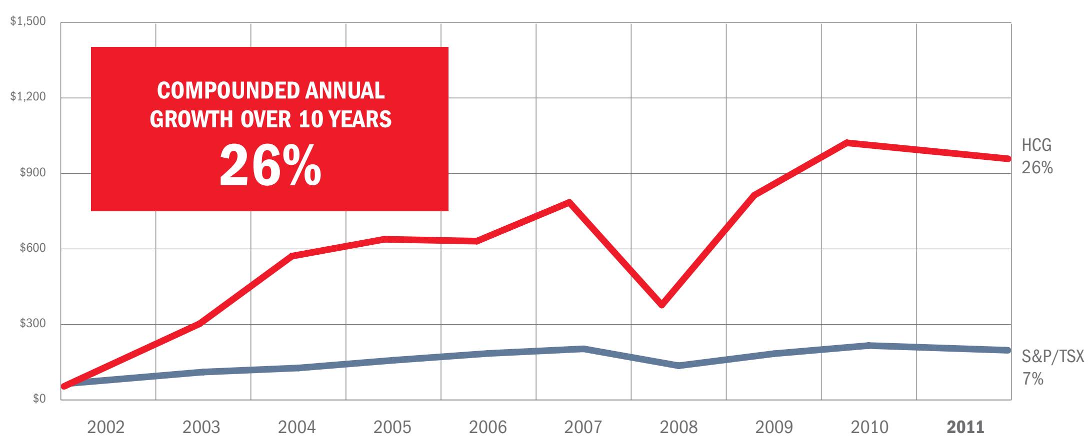
**27.4%**

**Adjusted* net income** for 2011 was $192.5 million, an increase of 30.4% over 2010

**$192.5 million**

*See definition of Non-GAAP Measures on page 63.

**Ten-year Cumulative Total Return on $100 Investment**
Comparison between S&P/TSX Composite Index (S&P/TSX) and Home Capital Group Inc. (HCG)
December 31, 2001–December 31, 2011




| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|---|---|---|---|---|
| **HCG Stock Price Performance** | $7.25 | $16.63 | $31.25 | $34.75 | $34.05 | $41.90 | $19.80 | $41.85 | $51.79 | $49.10 |

Closing Price as of December 31

Share prices have been restated to reflect two-for-one stock split on January 29, 2004.

| 2008 | 2007 | 2006 | 2005 | 2004 | 2003 | 2002 |
|---|---|---|---|---|---|---|
| 5,809,713 | 4,975,093 | 3,902,316 | 3,284,829 | 2,568,513 | 1,897,176 | 1,394,289 |
| 4,506,391 | 4,022,171 | 3,309,214 | 2,796,873 | 2,244,130 | 1,611,911 | 1,171,102 |
| – | – | – | – | – | – | – |
| 5,102,781 | 4,413,984 | 3,443,640 | 2,901,515 | 2,269,157 | 1,666,788 | 1,216,475 |
| 432,753 | 348,040 | 276,866 | 218,885 | 162,207 | 121,166 | 94,586 |
| 2,614,258 | 1,459,455 | 1,107,562 | 800,184 | 500,740 | 315,131 | 140,643 |
| 454,695 | 368,881 | 282,549 | 234,704 | 181,839 | 141,365 | 111,066 |
| 108,687 | 90,241 | 67,815 | 60,861 | 44,551 | 29,507 | 20,595 |
| 12.57 | 10.08 | 8.10 | 6.44 | 4.80 | 3.61 | 2.82 |
| 3.15 | 2.62 | 1.99 | 1.80 | 1.33 | 0.88 | 0.62 |
| 3.13 | 2.59 | 1.95 | 1.72 | 1.27 | 0.86 | 0.59 |

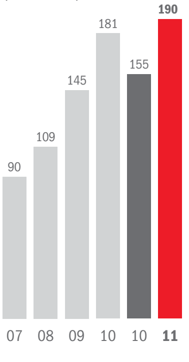
**Total assets** grew by 14.0% over 2010 to reach $17.70 billion at the end of 2011

**$17.70 billion**

**Adjusted*  basic earnings** per share were $5.55 for the year, an increase of 30.6% over 2010

**$5.55**

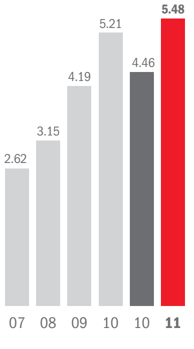
**Net Income**
($ millions)




**22.8%**

Home Capital reported a 22.8% increase in net income over the $154.8 million under IFRS attained in 2010, reaching $190.1 million for the year ended 2011.

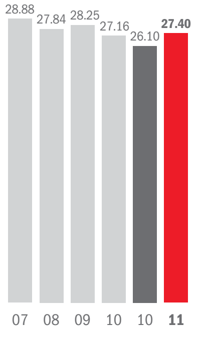
**Earnings per Share**
(basic in dollars)




**22.9%**

Basic earnings per share rose to $5.48 for the year ended December 31, 2011, a 22.9% increase over the $4.46 under IFRS for 2010.

**Adjusted* After-tax Return on Equity**
(percentage)




**27.4%**

Home Capital surpassed 20% return on equity for the 14th consecutive year, and 25% ROE for the 9th successive year, reaching 27.4% at December 31, 2011.

Former Canadian GAAP Basis   IFRS Basis   IFRS Basis

# Business Profile

**Home Capital Group Inc.**, together with its operating subsidiary Home Trust Company, has developed a track record of success as Canada's leading alternative lender. Building on the demonstrated strength of its core residential mortgage lending business, the Company also offers complementary lending services, as well as highly competitive deposit investment products.

### MORTGAGE LENDING

Home Trust is one of Canada's leading mortgage lenders, focusing on homeowners who typically do not meet all the lending criteria of traditional financial institutions. By offering a range of mortgage products, Home Trust is uniquely positioned to provide financial solutions to meet the needs of thousands of Canadians. With a proprietary lending approach, comprehensive borrower profiling and flexible alternative options, Home Trust is a one-stop shop for borrowers and mortgage brokers. Home Trust is also a provider of commercial first mortgages to high-quality borrowers in selected markets across Canada.

### CONSUMER LENDING

Home Trust's Equityline *Visa* program brings the advantages to cardholders of accessing the equity they have built in their homes together with the features and convenience of a Gold *Visa* card. The Company also offers deposit-secured credit cards for individuals who wish to build or re-establish a positive credit history. Home Trust's Retail Credit Services provides installment financing for customers making purchases from established businesses. PSiGate, a wholly owned subsidiary, offers electronic card-based payment services to merchants who conduct business primarily on the Internet.

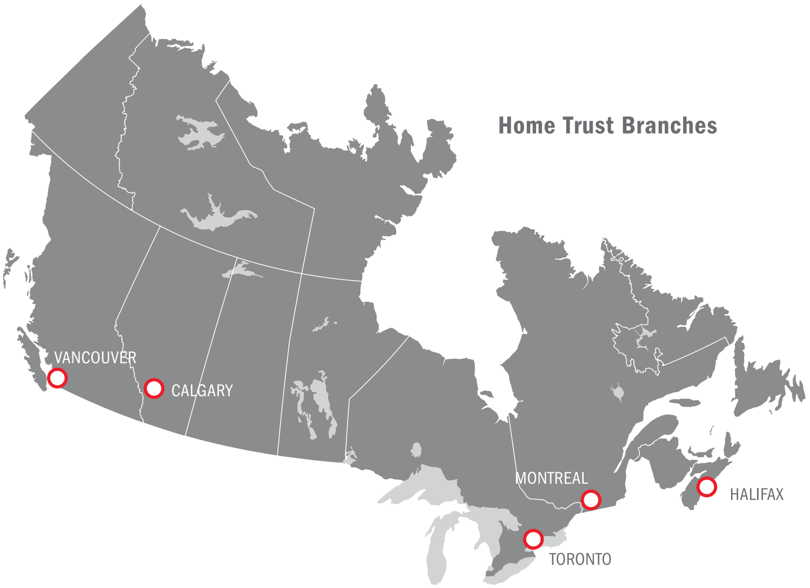
### DEPOSIT INVESTMENTS

Home Trust provides a broad range of deposit investment services including certificates of deposit, guaranteed investment certificates, registered retirement savings plans, registered retirement income funds and tax-free savings accounts. The Company has developed an extensive customer base and fostered strong relationships with hundreds of deposit brokers and investment dealers across the country. With efficient, personal service and competitive rates, Home Trust offers a number of solutions to meet the long-term and short-term needs of investors looking to diversify their portfolios.

# 25 Years of Expanding Geographic Reach

### MISSION STATEMENT

**Home Capital Group Inc.** exists to benefit its shareholders through the pursuit of above average returns over the long term and with a minimum of risk. This goal is pursued through the positioning of Home Capital's wholly owned subsidiary, Home Trust Company. Home Trust's business activity is focused on unique niches in the Canadian financial marketplace, each of which generates above average returns, has below average risk and is not adequately served by the larger, traditional financial institutions.




**CONTENTS** 

# 25 YEARS OF OUTSTANDING PERFORMANCE

A look back at some of the highlights of the last 25 years.

## 1986
Home Capital Group Inc. is established and acquires Home Savings & Loan Corporation to provide solutions to underserved niches in the financial services marketplace. The Company has 12 employees, $3 million in equity, $50 million in assets and a net loss of $373 thousand.

## 1987
Home Savings opens a branch in Toronto.

## 1988
The *Financial Post* declares that “Home Capital has evolved in less than two years into a profitable member of the financial services industry.”

## 1989
In order to focus on mortgage lending as its primary business, Home Capital disposes of other subsidiaries in its portfolio.

## 1990–1992
Home Capital faces the severe economic downturn with prudent lending and management strategies, establishing Home Savings as a strong contender in the financial services industry.

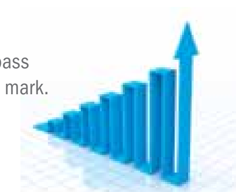
## 1993
The roles of Chairman and CEO are split, with an independent director serving as Chairman, paving the way for strong corporate governance practices.

## 1994
Home Capital successfully emerges from the recession with a proven business model and market niche, a strong balance sheet and an expanded mortgage broker network.

## 1995–1996
The Company repositions itself in order to thrive in the changing marketplace, reducing exposure to commercial mortgages and concentrating efforts on residential first mortgages.

## 1997
Home Capital’s mortgage portfolio and total assets grow by more than 20%, and the share price increases by more than 200%.

## 1998
Total assets surpass the $500 million mark.



## 1999
The Company introduces a quarterly dividend as a means of enhancing shareholder value.

Branch offices opened in Calgary and Vancouver, expanding the geographic reach of the Company.

## 2000
Home Savings receives Letters Patent to be continued under the Trust and Loan Companies Act as Home Trust Company.

Home Trust is accepted for General Membership in the *Visa* Canada Association and launches its first *Visa* credit card program.

## 2001
Home Capital’s Class A shareholders convert 1.5 million Class A multi-vote shares into the same number of Class B subordinated single-vote shares, without premium and with no dilutive effect on the Company’s earnings per share.

Total assets exceed $1 billion.

## 2002
Home Trust introduces the Equity Plus *Visa* credit card, enabling homeowners to access equity in their homes through a *Visa* credit card.

Halifax branch office opens to serve a growing client base in the Atlantic provinces.

Net income exceeds $20 million.

## 2003
Home Capital’s shares appreciate by nearly 130% during the year, from $7.25 at the close of 2002 to $16.63 at the end of 2003.

The remaining Class A multi-vote shares are converted into single-vote Class B shares on a one-for-one basis without premium, eliminating the Company’s dual class share structure.

## 2004
Home Capital splits its stock, creating greater liquidity for existing shareholders and improving market access to the Company’s shares.

Home Capital is added to the S&P/TSX Composite Index and receives an investment grade credit rating from Fitch Ratings Agency.

Market capitalization exceeds the $1 billion mark.

## 2005
The Equity Plus *Visa* card is relaunched as Equityline *Visa*, a *Visa* Gold product.

Standard & Poor’s assigns investment grade ratings to the Company.


Net income exceeds $60 million.

## 2006
Home Capital is named to Corporate Knights’ Annual Best 50 Corporate Citizens and receives the Ontario Chamber of Commerce Outstanding Business Achievement Award for Corporate Governance.

## 2007
Home Capital acquires PSiGate, a company that provides payment processing services to Internet-based merchants.

PSiGate
A WHOLLY OWNED SUBSIDIARY OF HOME CAPITAL GROUP INC.

Branch office opens in Montreal, reflecting an increased presence in the Quebec marketplace.

## 2008
*Accelerator* program is launched, offering a full range of insured mortgage products.

## 2009
Home Capital adopts a Shareholder Rights Plan.

## 2010
Home Trust’s Retail Credit Services department commences financing for water heaters, diversifying the Company’s product offerings to homeowners.

## 2011
Home Capital issues a $150 million debenture offering to help fund Home Trust’s future growth.

Home Trust implements SAP for Banking Solutions, a customized software and technology platform to support the future growth of the business.

Dominion Bond Rating Service issues investment grade ratings to the Company.

## Today
Home Capital marks 25 years of growth with over 550 employees, $775 million in equity, $17.70 billion in assets and over $190 million in net income.

# Report to Shareholders

**2011 was another year of record operating** and financial performance for Home Capital Group, as once again we met or exceeded all of our stated goals and objectives. In 2012 we will proudly celebrate our twenty-fifth year in business and a quarter century of superior growth through both prosperous and difficult economic conditions. Most importantly, we have consistently generated solid returns in all our lines of business, and we look to build on this track record of creating increasing value for our shareholders in the years ahead.

### Strong Performances

Despite the global economic uncertainty experienced during 2011, the Canadian real estate market remained strong and resilient through the year, resulting in Home Capital generating solid performance across all of its business lines. In addition, the credit quality of our loan portfolio remained strong, the result of our diligent underwriting and collection practices, and we are confident our solid and prudent capital and liquidity positions will help us successfully manage any impact future global economic issues may have on the Canadian economy.

Our proven business plan is the foundation of our continuing strong performance. At Home Capital, we have designed our value-enhancing programs to ensure the Company can deliver solid results through any and all phases of the economic cycle. Since the Company's founding twenty-five years ago, our focus has been on generating steady and sustainable growth in earnings while, at the same time, maintaining a stable risk profile with a strong financial position and industry-leading capital ratios. Each year we establish a set of objectives to benchmark our performance and, once again, in 2011 we met or exceeded the following objectives:

> Adjusted net income rose 30.4%, exceeding our target of 15% to 20% growth and, on an unadjusted basis, net income rose 22.8%;

> Adjusted diluted earnings per share were up 30.4% in 2011, also beating our objective of 15% to 20% growth and, on an unadjusted basis, diluted earnings per share increased by 22.7%;

> Total assets increased by 14.0%, within our target range of 13% to 18%;

> Adjusted return on shareholders' equity was 27.4%, once again beating our 20% goal, and the 14th consecutive year that our annual return on equity has exceeded 20%;

> Tier 1 and Total capital ratios were 17.3% and 20.5%, respectively, surpassing our minimum targets of 13% and 14%; and

> Provision for credit losses as a percentage of gross loans was 0.05%, within our target range of 0.05% and 0.15%.

In light of our continuing growth and the stability of our earnings, we were pleased to increase our quarterly dividends by 11.1% in August 2011 to $0.80 per common share on an annualized basis, the 13th common share dividend increase over the last seven years.

Our strong consolidated financial results in 2011 were the result of solid performance and returns on equity across all of our business lines.

The total value of our mortgage originations was $5.12 billion in 2011, compared to $6.87 billion in originations in 2010. During the year we scaled back insured mortgage originations under our *Accelerator* program and insured multi-unit residential program as, under IFRS accounting rules, new capital constraints served to increase the costs associated with securitized insured mortgages. As we stated last year, we increased emphasis on our traditional, higher yielding non-securitized mortgage business, and the 23.2% increase in traditional originations during 2011 is evidence of our success and a further demonstration of the resiliency and adaptability of our business model. Looking ahead, we will continue to capitalize on our ability to offer a full-service, one-stop shop to the Canadian mortgage market while evaluating new opportunities to generate enhanced returns from our securitized mortgage offerings.

Our Equityline *Visa* program remained strong in 2011, with a total of 7,697 new accounts opened during the year. Over the last few years we have introduced a number of new marketing initiatives aimed at expanding this line of business, and based on the current outlook for the Canadian economy, we believe our *Visa* portfolio will continue to generate solid profitability.

A key objective at Home Capital is to enhance the quality and strength of our capital base while reducing the Company's risk profile. At year-end, Home Trust remained well capitalized with solid Tier 1 and total capital ratios of 17.3% and 20.5%, respectively. In addition, the credit performance of our loans portfolio remained strong, with net impaired loans representing only 0.25% of the total portfolio as at December 31, 2011, well within our expected and acceptable range. To further strengthen our capital base, in May 2011 we successfully completed a $150 million offering of 5.2% debentures, with the net proceeds providing additional capital for our future growth.

Our strong capital base and conservative risk profile are reflected in the continuing strong credit ratings awarded to the Company. Fitch Ratings assigned both Home Capital and Home Trust a BBB rating with a stable outlook for both companies. Standard & Poor's and DBRS assigned BBB ratings to Home Capital, and BBB+ and BBB (high) ratings, respectively, to Home Trust, again with a stable outlook for both companies.

Looking ahead, we believe the Canadian housing market will generally remain resilient to global economic uncertainty, with balanced supply and demand across most of the geographic regions in which we operate; however, we are well positioned to withstand a downturn in real estate markets, should one occur. More than 60% of our loan portfolio is insured and the remaining portion comprises loans secured by real estate with average loan to value ratios at origination of less than 70%. Our strong Tier 1 capital ratio positions the Company to absorb loan losses at many times our current or historical rates, and we remain vigilant for indications of credit problems within our portfolio. With our proven marketing programs, new product offerings, an expanded broker network, a clear focus on superior customer service, and our full-service mortgage offering, we believe Home Capital will generate continued strong performance and shareholder returns over the long term.

## 25 YEARS OF SUPERIOR CUSTOMER SERVICE

Being Canada's leading alternative lender means more than offering innovative products to Canadians. It also means caring about our customers and finding solutions to meet individual needs. Our employees are committed to delivering superior service to every customer, every time.

### A Strong Platform for Growth

During 2011 we further strengthened our operating and management team with new and experienced people as well as enhanced training and innovative tools in our risk management, internal audit and compliance areas. These improvements to our control functions are essential to supporting our future growth and strategic priorities, and we will continue to enhance our operating platform in the quarters ahead.

In May 2011 we were pleased to appoint Robert J. Blowes, CA, CPA, as Chief Financial Officer of Home Capital and Home Trust. Bob joined the Company in 2010 as Senior Vice President, Finance, and brings significant financial services and public company experience to Home Capital.

To provide the necessary tools and support for our operating team, and to drive growth in the years ahead, in July 2011 we went live with new technology solutions from the *SAP® For Banking* portfolio, effectively becoming a North American leader in this technology space. The SAP platform has enabled us to build a portal to reach our broker community and provide them with the tools to access their customer information. At the same time, we are seeing improvements in user productivity with the ability to enter and process more deals without increasing our staff. The SAP platform will provide us with the tools to further streamline our operations, and provide faster turnaround for new business products, all with improved access to information to better support our decision making and service to our customers.

In line with the implementation of our new technology platform, we also launched an organizational effectiveness initiative to drive improved operational efficiency and manage our costs. We look for these programs to further enhance profitability going forward.

# DELIVERING OUTSTANDING SHAREHOLDER VALUE
## FOR 25 YEARS

With solid financial results, strong earnings growth and returns on equity, Home Capital has delivered outstanding value to shareholders for 25 years. Named a "Star Stock of the Decade" by *The Globe and Mail* in 2010, Home Capital's shares have increased by nearly 5,000% since the Company's inception.

We were pleased to have strengthened our Board of Directors subsequent to year-end with the appointment of James C. Baillie as a Director of Home Capital. Mr. Baillie is counsel at Torys LLP in Toronto and is recognized as one of Canada's leading corporate legal practitioners. He has had an active interest and involvement in financial institution regulation as well as advising financial institutions and other clients on complex transactions and policy issues. He is also past-Chairman of the Ontario Securities Commission. We are confident that his extensive experience and depth of knowledge will be valuable assets to the Board and the Company.

## An Exciting Future

Looking ahead, we will continue to build on the growth and progress demonstrated over our twenty-five years in business. Our strategic priorities and proven business model have shown time and time again that our Company can prosper through both good and challenging times. We are confident that our strong capital position, our focus on sustainability and accountability, and the continuing execution of our strategy will continue to generate strong returns for our shareholders over the long term.

Once again, we have established financial and operating targets for 2012 as follows:

> 13% to 18% growth in total net earnings;

> 13% to 18% growth in diluted earnings per share;

> 13% to 18% growth in total loans;

> 20% return on shareholders' equity;

> Minimum Tier 1 and Total capital ratios of 13% and 14%, respectively; and

> Provision for credit losses as a percentage of gross loans within 0.05% and 0.15%.

In addition to our financial objectives, we continue to target improvements to our governance, risk and control processes to further enhance shareholder value and strengthen the security of the investments of our depositors.

Finally, our success over the last twenty-five years is the result of the hard work, dedication and commitment of everyone at Home Capital. We believe our employees are among the best in the Canadian financial services industry, and on behalf of the Board of Directors and our shareholders, we extend thanks to our entire team. It is their diligence and contribution, day after day, that has led to our growth and prosperity, and we look to build on this progress in the years to come.

**Dr. Kevin P.D. Smith**
*Chairman of the Board*

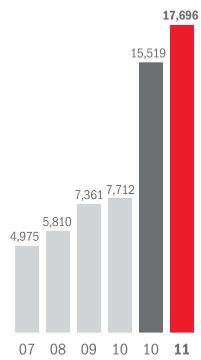
**Gerald M. Soloway**
*Chief Executive Officer*

# Proven Results

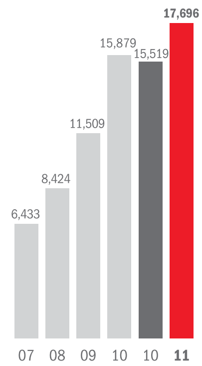
## GROWTH

Home Capital sustained its strength in key financial measurements. The Company's core business activities generated strong results, contributing to asset growth of 14.0% and an increase in total revenue of 15.0%.

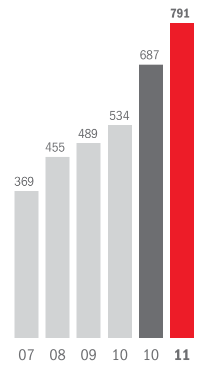
**Assets**
($ millions)




**Total Assets Including Assets under Administration**
($ millions)



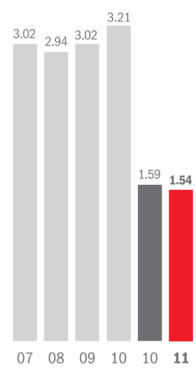

**Revenue**
($ millions)



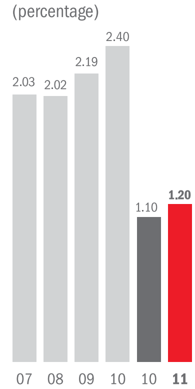

## RETURNS

The Company recorded pre-tax return on assets of 1.54% and after-tax return on assets of 1.20%, while shareholders' equity increased to $774.8 million, a 23.3% rise from the previous year.

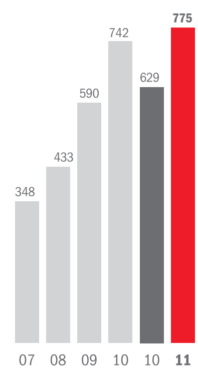
**Pre-tax Return on Assets**
(percentage)




**After-tax Return on Assets**
(percentage)



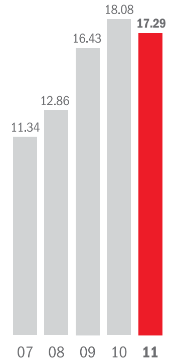

**Shareholders' Equity**
($ millions)



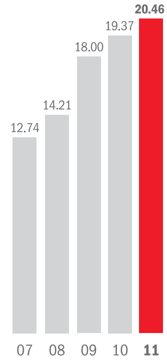

## RISK

Home Capital continued to surpass all applicable regulatory and related standards. The level of impaired loans is comparable to that of large, traditional financial institutions. Home Capital's robust risk management framework is a key component of the Company's philosophy.

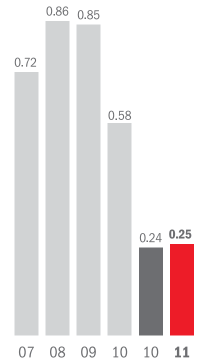
**Tier 1 Capital to Risk-Weighted Assets**
(percentage)




**Total Capital to Risk-Weighted Assets**
(percentage)




**Net Impaired Loans of Loan Portfolio**
(percentage)




Former Canadian GAAP Basis   IFRS Basis   IFRS Basis

## Performance vs. Target

| | | |
|---|---|---|
| **RETURN ON EQUITY**<br><br>**TARGET:**<br>20% adjusted* return on equity | Home Capital exceeded 20% in adjusted* return on equity, reaching 27.4% for the year ended December 31, 2011, representing the 14th consecutive year in which the Company surpassed 20% ROE. | Adjusted* return on equity at<br>**27.4%** ▲<br>for the year ended December 31, 2011 |
| **EARNINGS**<br><br>**TARGET:**<br>15% to 20% increase in adjusted* net earnings | The Company reported adjusted* net earnings of $192.5 million for the year ended December 31, 2011, representing a 30.4% increase over the $147.6 million achieved in 2010. | Increase in adjusted* earnings of<br>**30.4%** ▲<br>over 2010 |
| **EARNINGS PER SHARE**<br><br>**TARGET:**<br>15% to 20% increase in adjusted* diluted earnings per share | Diluted earnings per share rose to $5.53 on an adjusted* basis at December 31, 2011, a 30.4% increase over the $4.24 recorded for 2010. | Adjusted* diluted earnings per share grew<br>**30.4%** ▲<br>over 2010 |
| **ASSETS**<br><br>**TARGET:**<br>13% to 18% increase in total assets | Total assets grew to $17.70 billion by December 31, 2011, an increase of 14.0% over the $15.52 billion recorded on December 31, 2010. | Total assets increased<br>**14.0%** ▲<br>over year-end 2010 |

*See definition of Non-GAAP Measures on page 63.

# ENVIRONMENTAL COMMITMENT

Home Capital is committed to implementing environmentally sustainable business practices that reduce our impact on the environment and encourage our employees to make green choices. The Company participates in a number of programs to reduce energy consumption and greenhouse gas emissions, and has implemented initiatives that promote green practices and motivate employees to reduce, reuse and recycle.

The Company's Environmental Committee has adopted a holistic approach to raising environmental awareness among employees across the country, supporting simple changes that make a difference in the Company's environmental impact.

**Some highlights of Home Capital's green activities in 2011 include:**

> **Reducing paper costs across the Company by over 15%, while ensuring Forest Stewardship Council certified paper is used in all branches**

> **Participating in comprehensive composting, recycling and waste disposal programs where available**

> **Diverting electronic waste through donations of obsolete computer equipment to charitable organizations**

> **Installing water filtrations systems in branch offices to reduce the demand for bottled water**

> **Discontinuing the use of disposable plastic utensils, replacing them with reusable utensils, diverting 90,000 plastic utensils from landfills last year**

> **Participating in Toronto's 20-Minute Makeover, during which a number of employees headed outdoors to collect litter and clean up the surrounding neighbourhood**

> **Implementing recycling programs for used pens and markers through a firm that makes a donation to charity for each recycled item collected**

In addition to the above initiatives, the Environmental Committee continues to foster awareness by posting weekly green tips on the Company's intranet and sponsoring "Random Acts of Green-ness" where employees recognize and share the green initiatives of their colleagues.

Employees are encouraged to turn off desktop electronic devices and lighting when not in use, reduce paper consumption by using available electronic communication methods, and use teleconferencing when applicable to reduce the need for travel.

The Company engaged a waste disposal company to conduct a waste audit in the Toronto office to ascertain where employees could improve upon recycling and composting practices. As a result, the Environmental Committee made recommendations for changes to garbage disposal and recycling practices in workstations and staff kitchens.

As in years past, Home Capital participated in the Carbon Disclosure Project, an independent not-for-profit organization holding the largest database of primary corporate climate change information in the world.

The office tower that accommodates Home Trust's main branch in Toronto has once again been recognized by the Building Owners and Managers Association as a building employing environmental best practices. This building sustainability certification is a unique, voluntary program designed to assess environmental performance and management of existing buildings.

Home Capital remains dedicated to reducing the Company's environmental impact by encouraging employee awareness, supporting green business practices and participating in initiatives that benefit the environment in practical and meaningful ways.

# Corporate Governance at Home Capital

**Home Capital recognizes the importance** of strong and effective corporate governance. As a publicly traded company, Home Capital has governance standards that reflect best practices, are consistent with the corporate governance guidelines set out by the Toronto Stock Exchange and are compliant with applicable rules adopted by the Canadian Securities Administrators.

The Board of Directors of Home Capital ensures that appropriate structures and procedures are in place so that it can independently and effectively oversee the Company's strategy, risk profile and operations with the objective of enhancing shareholder value. The Company continually looks for ways to improve its corporate governance policies and procedures, and the Governance, Nominating and Conduct Review Committee is responsible for reviewing Home Capital's corporate governance practices on at least an annual basis.

Home Capital's strategic and financial plans and risk appetite are reviewed and approved by the Board on at least an annual basis, and throughout the year the Board receives strategic updates from each of the principal business groups and risk updates from the Enterprise Risk Management department as part of regular Board meetings.

The Board has responsibility for the stewardship of Home Capital and for the supervision of the management of the business affairs of the Company, including creating a culture of integrity throughout the Company. All employees, officers and directors are subject to Home Capital's Code of Business Conduct and Ethics, which requires that the highest standards of ethical behaviour be maintained in all dealings on behalf of the Company.

### Highlights of Home Capital's corporate governance framework include:

- Eight of nine directors are independent, and the roles of CEO and Chairman of the Board are separate
- The Board is responsible for adopting and annually approving the Company's strategic plan and risk appetite including a review of business opportunities and threats
- The Board reviews and approves all critical risk policies, delegations of authorities and Company-wide limits
- The Board and its Committees function under charters that specify their roles, accountabilities and responsibilities
- The Board of Directors hold in-camera meetings of the independent directors at every Board meeting, and with the Chief Financial Officer, Chief Risk Officer, Head of Internal Audit, Chief Compliance Officer and Chief Anti-Money Laundering Officer no less than quarterly
- The Chair of the Governance, Nominating and Conduct Review Committee conducts an annual Board Evaluation Survey to assess the effectiveness of the Board and its Committees, as well as the effectiveness of each director through a self-evaluation and one-on-one meetings with the Chairman of the Board
- Home Capital provides an orientation program for new directors as well as conducting internal education sessions
- The Company maintains a minimum share ownership requirement for directors and the Chief Executive Officer to ensure alignment with the interests of all shareholders
- The Board has adopted a Shareholder Rights Plan to preserve the fair treatment of all shareholders in the event of a take-over bid
- Home Capital has appropriate systems in place to identify, assess and mitigate risk, and the Board is responsible for the oversight of the Company's risk management initiatives

Home Capital is committed to robust corporate governance principles and practices that support the Company's business. For more information about corporate governance at Home Capital, please refer to:

### Home Capital's Management Information Circular

The Circular contains detailed information about directors and management, as well as the Company's Statement of Corporate Governance Practices.

### www.homecapital.com

The Company's website contains information about corporate governance at Home Capital, including the Statement of Corporate Governance Practices, Charters of the Board of Directors and Board Committees, Position Descriptions, Director Independence Standards, Code of Business Conduct and Ethics, and Shareholder Rights Plan.

### Annual and Special Meeting

All shareholders are encouraged to attend the Company's Annual and Special Meeting on May 16, 2012 (details on page 117) or listen to the webcast available through the website at www.homecapital.com.

# Management's Discussion and Analysis

### Caution Regarding Forward-looking Statements

From time to time Home Capital Group Inc. (the "Company" or "Home Capital") makes written and verbal forward-looking statements. These are included in the Annual Report, periodic reports to shareholders, regulatory filings, press releases, Company presentations and other Company communications. Forward-looking statements are made in connection with business objectives and targets, Company strategies, operations, anticipated financial results and the outlook for the Company, its industry, and the Canadian economy. These statements regarding expected future performance are "financial outlooks" within the meaning of National Instrument 51-102. Please see the risk factors, which are set forth in detail in the Risk Management section of this report, as well as its other publicly filed information, which are available on the System for Electronic Document Analysis and Retrieval (SEDAR) at www.sedar.com, for the material factors that could cause the Company's actual results to differ materially from these statements. These risk factors are material risk factors a reader should consider, and include credit risk, liquidity and funding risk, structural interest rate risk, operational risk, investment risk, strategic and business risk, reputational risk and regulatory and legal risk along with additional risk factors that may affect future results. Forward-looking statements can be found in the Report to the Shareholders and the Outlook section in the Annual Report. Forward-looking statements are typically identified by words such as "will," "believe," "expect," "anticipate," "estimate," "plan," "may," and "could" or other similar expressions.

By their very nature, these statements require the Company to make assumptions and are subject to inherent risks and uncertainties, general and specific, which may cause actual results to differ materially from the expectations expressed in the forward-looking statements. These risks and uncertainties include, but are not limited to, global capital market activity, changes in government monetary and economic policies, changes in interest rates, inflation levels and general economic conditions, legislative and regulatory developments, competition and technological change. The preceding list is not exhaustive of possible factors.

These and other factors should be considered carefully and readers are cautioned not to place undue reliance on these forward-looking statements. The Company does not undertake to update any forward-looking statements, whether written or verbal, that may be made from time to time by it or on its behalf, except as required by securities laws.

Assumptions about the performance of the Canadian economy in 2012 and its effect on Home Capital's business are material factors the Company considers when setting its objectives and outlook. In determining expectations for economic growth, both broadly and in the financial services sector, the Company primarily considers historical and forecasted economic data provided by the Canadian government and its agencies. In setting and reviewing the outlook and objectives for 2012, management's expectations assume:

> The Canadian economy will produce modest growth in 2012, but will be heavily influenced by the economic conditions in the United States and international markets. Inflation will generally be within the Bank of Canada's target of 1%–3%.
> Interest rates will remain at current rates for 2012 as the Bank of Canada leaves its target for the overnight rate at its current level.
> The housing market will remain resilient to global uncertainty with balanced supply and demand conditions in most regions. Declining housing starts and flat resale activity on stable prices through most of Canada will continue with the market stabilizing from previous activity levels.
> Unemployment will remain stable or improve slightly as the economy grows, while a larger labour force will tend to offset job growth. Consumer debt levels will remain serviceable by Canadian households.
> Net interest margins overall are expected to remain in the current range. Margins are expected to remain stable as returns on the increased traditional portfolio offset declining returns on the securitized portfolio throughout 2012.
> Credit quality will remain sound with actual losses within Home Capital's historical range of acceptable levels.
> Current Canada Mortgage and Housing Corporation (CMHC) policies remain substantially unchanged.

### Regulatory Filings

The Company's continuous disclosure materials, including interim filings, annual Management's Discussion and Analysis and audited consolidated financial statements, Annual Information Form, Notice of Annual Meeting of Shareholders and Proxy Circular are available on the Company's website at www.homecapital.com, and on the Canadian Securities Administrators' website at www.sedar.com.

*The following section of this report provides management's detailed discussion and analysis of the financial condition and results of operations of Home Capital Group Inc. for the year ended December 31, 2011. The discussion and analysis relates principally to the Company's subsidiary, Home Trust Company (Home Trust), which provides residential mortgage lending, non-residential mortgage lending, consumer lending and deposit-taking services. This section also reviews the Company's risk management policies relating to credit, liquidity, market and capital risks that are applicable to the Company's financial results.*

*Comparative performance indicators of the Canadian banking industry referred to in this document come from the published results of publicly traded Schedule I banks. Readers are reminded that the banks in this industry grouping have operations and asset sizes that may not be comparable to each other or to Home Trust. The Company obtains comparative performances from third-party sources. While the Company believes this information to be reliable, the Company has not independently verified the data and cannot provide any assurances as to its accuracy.*

# Management's Discussion and Analysis

## BUSINESS PROFILE AND STRATEGY

Home Capital is a holding company that operates primarily through its principal, federally regulated subsidiary, Home Trust, which offers insured deposits, residential and non-residential mortgage lending and consumer lending. The Company's subsidiary Payment Services Interactive Gateway Inc. (PSiGate) provides payment card services. Licensed to conduct business across Canada, Home Trust has offices in Ontario, Alberta, British Columbia, Quebec and Nova Scotia.

### Business Segments and Portfolios

The Company divides its business into three segments. These segments and the related activities and portfolios are described below.

*Mortgage Lending*

This segment comprises single-family residential lending and multi-unit residential lending as well as non-residential lending. The single-family residential portfolio includes the Company's traditional or "Classic" mortgage loans and Accelerator mortgages. The Company's traditional mortgage portfolio consists of mortgages with loan to value ratios of 80% or less, where the focus is on serving selected segments of the Canadian financial services marketplace that are not the focus of the major financial institutions. Accelerator mortgages are insured, with loan to value ratios generally exceeding 80%, at the time of origination, and are generally securitized and sold through Canada Mortgage and Housing Corporation (CMHC) sponsored mortgage-backed securities (MBS) and Canada Mortgage Bond (CMB) programs.

Multi-unit residential lending includes both insured and uninsured mortgage loans. Non-residential lending includes store and apartment mortgages, commercial mortgages and warehouse commercial mortgages.

*Consumer Lending*

Consumer lending includes *Visa* lending and other consumer retail lending for durable household goods, such as water heaters and larger ticket home improvement items. Consumer retail lending loans are supported by holdbacks or guarantees from the distributors of such items and/or collateral charges on real property. The Company's Equityline *Visa* product, secured by real property, represents 97.8% of the *Visa* portfolio. The Company also offers cash secured *Visa* products. The consumer lending segment includes the operations of PSiGate.

*Other*

In addition to its operating segments, the Company accounts for treasury portfolio and general corporate activities.

### Mission, Governing Objectives and Values

**The Company's mission is to focus on well-defined niches in the Canadian financial marketplace that generate above average returns, have below average residual risk profiles, and are not adequately served by traditional financial institutions.**

The Company's objectives are to deliver superior shareholder value, and ensure that depositors are protected at all times, without exception, as measured by:

> a return on common equity of at least 20%;

> capital aligned with the risk profile of the business and the needs of the Company's depositor base.

The Company has a set of values that are integral to its day-to-day business. These values are the cornerstone of Home Capital's vision and play a key role in the Company achieving both its strategic and financial performance goals:

> consistently enhance shareholder value by adhering to our strategies and principles with a focus on customer service

> act with respect, trust and integrity in all interactions with our customers, employees and business partners

> personal responsibility to deliver the highest level of customer service to our clients, supported by our enthusiasm, teamwork and desire for continuous improvement

> make a positive difference to our community and environment through fundraising, community involvement and sustainable environmental initiatives

**The Company's key long-term objective is to deliver superior shareholder value.**

The Company seeks to achieve a return on common equity of at least 20%, and has exceeded this benchmark in each of the past 14 years without exception. Management also seeks to align its capital with the risk profile of the business through an understanding of the nature and level of risk being taken and how these risks attract regulatory and risk-based capital.

### Risk-taking Philosophy

Home Trust's core strategy focuses on serving a large portion of the Canadian financial services market that has traditionally been un-served or underserved by larger financial institutions. Our strategy provides opportunity for higher returns but carries an inherently different risk profile than one serving the broader market and requires an integrated risk management strategy. Home recognizes this risk and proactively seeks to reduce overall risk exposure to a low level through:

> active Board and senior management development, monitoring and timely revision of corporate strategies, risk appetite and risk mitigation activities;

> promotion of a sound risk management culture and awareness throughout the entire organization;

> adoption of a conservative financial risk profile, comprising prudent levels of liquidity; capital levels in excess of regulatory and risk based minimums; and reserves that account for all incurred losses;

> extensive, customized risk evaluation practices and controls at the transactional level executed by experienced personnel and supported by effective and efficient processes and technology; and

> proactive, independent and timely monitoring and assessment of all risk exposures, regardless of source, by the Enterprise Risk Management (ERM) group.

## 2011 PERFORMANCE AND 2012 STRATEGIES AND TARGETS

### 2011 Performance

The table below summarizes the Company's 2011 targets and performance.

**Table 1: 2011 Targets and Performance**

| | | | For the year ended December 31, 2011 | |
|---|---|---|---|---|
| | 2011 Targets[1] | **Actual Results[1]** | **Amount** | **Increase over 2010** |
| Growth in adjusted net income[2] | 15%–20% | **30.4%** | **$ 192,505** | **$ 44,895** |
| Growth in adjusted diluted earnings per share[2] | 15%–20% | **30.4%** | **5.53** | **1.29** |
| Growth in total assets[3] | 13%–18% | **14.0%** | **17,696,471** | **2,177,653** |
| Growth in total loans[3] | 13%–18% | **14.2%** | **16,089,648** | **1,997,893** |
| Adjusted return on shareholders' equity | 20.0% | **27.4%** | | |
| Efficiency ratio (TEB)[4] | 28.0%–34.0% | **27.9%** | | |
| Capital ratios[5] | | | | |
| Tier 1 | Minimum of 13% | **17.3%** | | |
| Total | Minimum of 14% | **20.5%** | | |
| Provision as a percentage of gross loans | 0.05%–0.15% | **0.05%** | | |

[1] Targets and results for adjusted net income and diluted earnings per share are for the current year.

[2] Targets are based on adjusted 2010 net income. See definition of Adjusted Net Income under Non-GAAP Measures and reconciliation under the International Financial Reporting Standards section of this report. Change represents change over 2010.

[3] Change represents growth over December 31, 2010.

[4] See definition of Taxable Equivalent Basis (TEB) under Non-GAAP Measures in this report.

[5] Based on the Company's wholly owned subsidiary, Home Trust Company.

The Company implemented the new Canadian generally accepted accounting principles (GAAP) financial reporting framework, International Financial Reporting Standards (IFRS) on January 1, 2011, with a transition date of January 1, 2010. Transition as at January 1, 2010 required restatement of the Company's 2010 financial information from its original Canadian GAAP basis to the IFRS basis. This allows for inclusion of comparative information in the 2011 financial statements. On transition, IFRS required the application of certain mandatory and optional transition exemptions. The details of the restatement and the mandatory and selected optional exemptions, which the Company applied on transition, are set out in Note 26 to the accompanying consolidated financial statements.

As IFRS represents a new Canadian GAAP accounting framework, it is generally not appropriate to directly compare the Company's financial position and results of operations as stated under IFRS to the financial position and results of operations as stated under original Canadian GAAP. Comparative information in this Management's Discussion and Analysis (MD&A), including tables, has been restated to the IFRS basis unless otherwise indicated. Please see the International Financial Reporting Standards section of this MD&A for further information.

Non-GAAP measures are discussed in the Non-GAAP Measures section located at the end of this MD&A.

# Management's Discussion and Analysis

## 2011 Strategies and Achievements

The Company employs three strategic priorities to achieve its long-term objectives:

| STRATEGIC PRIORITY | 2011 STRATEGIES AND ACHIEVEMENTS |
|---|---|
| **Focused Marketplace Growth** | Build and maintain Canada's leading alternative financial institution<br>> Sustained focus on underserved niches and achieved a market-leading position<br>> Continued to offer "one-stop" convenience to borrowers and brokers, while focusing on the high value alternative mortgage segment<br>> Continued the expansion of the geographic footprint of the business<br>> Maintained industry-leading service levels to clients and mortgage brokers |
| **Prudent Balance Sheet Management** | Improve the financial strength of the Company so that it is capable of absorbing market events and position the Company for strong shareholder returns<br>> Maintained a strong capital position, with a Tier 1 capital ratio of 17.3% at the end of 2011 and the increase in total capital of Home Trust, through $100 million of subordinated debt funded by $150 million senior debt successfully issued by Home Capital<br>> Maintained the prudent credit risk profile of the loan portfolio, with net impaired loan ratios and loan provisions at low levels in 2011<br>> Maintained and managed strong liquidity positions; average liquid assets decreased during the course of the year as the Company balanced liquidity against investment returns<br>> Maintained a flexible supply of funding through the deposit broker network and continued to utilize funding through securitization markets |
| **Operational and Governance Excellence** | Invest in robust corporate governance, risk management and efficient customer-focused processes and systems<br>> Continued to achieve industry-leading returns to shareholders' equity<br>> Further enhanced risk measurement, monitoring and reporting capabilities<br>> Achieved a low level of credit losses through strong underwriting, active portfolio monitoring and collections activities<br>> Maintained leading cost efficiencies through tight cost controls<br>> Completed the development and implementation of a core banking system that will enhance customer interactions and maintain high levels of efficiency and reliability while providing additional scalability |

## 2012 Strategic Priorities

Strategic priorities for 2012 will include the three priorities previously noted along with strategies that include greater diversification of the Company's sources of funding and the development of a new complementary strategy that will focus on fee revenue from loan origination and administration for other mortgage funders through the sale of fully insured mortgages. Execution of these strategies will lower the overall business risk of the Company by reducing funding risk and increasing capacity to generate fee income from mortgage origination and administration services.

## 2012 Performance Targets

The following table summarizes the Company's 2012 performance targets.

### Table 2: Targets for 2012

| | 2012 Targets | Dollar Amount |
|---|---|---|
| Growth in net income | 13%–18% | $214.8 million–$224.3 million |
| Growth in diluted earnings per share | 13%–18% | $6.17 per share–$6.44 per share |
| Growth in total loans | 13%–18% | $18.18 billion–$18.99 billion |
| Return on shareholders' equity | 20.0% | |
| Efficiency ratio (TEB)[1] | 28.0%–34.0% | |
| Capital ratios[2] | | |
| Tier 1 | Minimum of 13% | |
| Total | Minimum of 14% | |
| Provision as a percentage of gross loans | 0.05%–0.15% | |

1 Refer to the definition of TEB under the Non-GAAP Measures section of this report.

2 Based on the Company's wholly owned subsidiary, Home Trust Company.

## 2011 Overall Outlook

Through 2011, the Company successfully repositioned the business to take advantage of the attractive returns available in the alternative mortgage space, the Company's traditional business. This business provides superior returns to the allocated capital and the Company will maintain focus on prudently expanding this business while continuing to strengthen operating controls and risk management processes. The Company will still offer insured mortgages through the Accelerator program, supporting the "one-stop" and "flexible lending solutions" lender strategy. The Company will also continue to increase its geographic footprint across Canada, taking advantage of opportunities within its risk profile in Quebec, and eastern and western Canada. Growth of the consumer portfolio at the current rate is expected for 2012.

In view of the global financial environment, the Company will maintain relatively high levels of liquidity and low overall leverage, as measured by the asset to capital multiple (ACM), to ensure safety and soundness for its depositors. This conservative approach to liquidity and leverage will drive a new complementary strategy that will focus on fee revenue from loan origination and administration for other mortgage funders.

The Company expects that the rate of growth in the Company's funded loan portfolio in 2012 will be consistent with the moderate pace of growth experienced in 2011. The traditional mortgage business is expected to maintain strong net interest margin and net interest income levels, while net interest margins on securitized assets are anticipated to decline modestly from the levels experienced in 2011. The decline primarily reflects a combination of two factors: spreads on new securitization transactions are generally lower than the spreads earned on the maturing pools and are lower than the spreads earned on the 2008 and 2009 securitization transactions; and the assets provided as replacement assets in the CMB program are generally lower yielding when compared to the maturing or discharging assets. While the Company actively hedges the CMB reinvestment risk, the hedges cannot absorb 100% of this risk. This dynamic will tend to put pressure on the overall net interest margin. The increased weighting of the Company's traditional uninsured mortgages tends to offset this downward pressure, as the margins on these products are more favourable.

The Company will record amortization expenses related to its new core banking system for the full year 2012. These charges, along with related support costs, will tend to increase the cost structure and efficiency ratio. Reductions in other areas and increases in net interest income will tend to mitigate the increases in amortization and other costs. The Company expects its efficiency ratio for 2012 to fall within the target range indicated above.

## FINANCIAL HIGHLIGHTS

### Table 3: Key Performance Indicators

| (000s, except % and per share amounts) For the years ended December 31 | **2011 IFRS** | 2010 IFRS | 2009 Cdn GAAP[1] | 2008 Cdn GAAP[1] | 2007 Cdn GAAP[1] |
|---|---|---|---|---|---|
| **FINANCIAL PERFORMANCE MEASURES** | | | | | |
| Total revenue | **$ 790,591** | $ 687,249 | $ 489,179 | $ 454,695 | $ 368,881 |
| Net income | **190,080** | 154,752 | 144,493 | 108,687 | 90,241 |
| Adjusted net income[2] | **192,505** | 147,610 | 144,493 | 108,687 | 90,241 |
| Earnings per share basic/diluted | **5.48/5.46** | 4.46/4.45 | 4.19/4.15 | 3.15/3.13 | 2.62/2.59 |
| Adjusted earnings per share basic/diluted[2] | **5.55/5.53** | 4.25/4.24 | 4.19/4.15 | 3.15/3.13 | 2.62/2.59 |
| Dividends per share | **0.76** | 0.66 | 0.58 | 0.50 | 0.44 |
| Adjusted return on shareholders' equity[2] | **27.4%** | 26.1% | 28.2% | 27.8% | 28.9% |
| Return on average total assets | **1.2%** | 1.1% | 2.2% | 2.0% | 2.0% |
| Net interest margin (TEB)[3] | **2.06%** | 2.07% | 2.80% | 2.90% | 3.40% |
| Net interest margin non-securitized assets (TEB)[3] | **3.05%** | 2.82% | – | – | – |
| Net interest margin securitized assets | **1.23%** | 1.23% | – | – | – |
| Efficiency ratio (non-interest expense as a % of net revenue) | **28.5%** | 30.0% | 27.2% | 28.5% | 27.9% |
| Efficiency ratio (TEB) (non-interest expense as a % of net revenue)[3] | **27.9%** | 29.3% | 26.5% | 28.0% | 27.1% |
| **FINANCIAL CONDITION MEASURES** | | | | | |
| Total assets | **$ 17,696,471** | $ 15,518,818 | $ 7,360,874 | $ 5,809,713 | $ 4,975,093 |
| Cash and securities-to-total assets | **7.9%** | 8.2% | 21.5% | 18.5% | 16.6% |
| Total loans | **$ 16,089,648** | $ 14,091,755 | $ 5,468,540 | $ 4,531,568 | $ 4,045,571 |
| Securitized loans | **8,243,350** | 8,116,636 | 4,147,711 | 2,614,258 | 1,459,455 |
| Tier 1 capital ratio[4] | **17.3%** | 18.1% | 16.4% | 12.9% | 11.1% |
| Total capital ratio[4] | **20.5%** | 19.4% | 18.0% | 14.2% | 12.5% |
| Credit quality | | | | | |
| Provision for credit losses as a % of gross loans | **0.05%** | 0.07% | 0.21% | 0.15% | 0.15% |
| Net non-performing loans as a % of gross loans | **0.25%** | 0.24% | 0.85% | 0.86% | 0.72% |
| Allowances as a % of gross non-performing loans | **74.9%** | 88.1% | 62.1% | 66.7% | 81.3% |

1 Figures prior to 2010 represent previous Canadian GAAP balances and have not been restated to IFRS.

2 See definition of Adjusted Net Income under Non-GAAP Measures.

3 See definition of Taxable Equivalent Basis (TEB) under Non-GAAP Measures.

4 These figures relate to the Company's operating subsidiary, Home Trust Company. The figures prior to 2011 have not been restated to IFRS.

## Overview

For the year ended December 31, 2011, the Company reported record net income of $190.1 million or $5.46 diluted earnings per share and adjusted net income of $192.5 million or $5.53 diluted earnings per share. Adjusted return on shareholders' equity was strong at 27.4% for the year. The efficiency ratio (TEB) remained favourable at 27.9%. Loan originations in the traditional portfolio increased year over year while Accelerator mortgage originations moderated compared to 2010. The Company maintained its prudent credit profile in the loan portfolio and its strong capital base. The Company's key financial highlights for 2011 are summarized below.

## Income Statement Highlights for 2011

> Adjusted net income of $192.5 million in 2011, increased by $44.9 million or 30.4% from adjusted net income of $147.6 million in 2010, reflecting higher loan balances, strong net interest margins, lower credit provisions and a consistently low efficiency ratio.

> Adjusted diluted earnings per share increased to $5.53, up $1.29 or 30.4% from the adjusted diluted earnings per share of $4.24 earned in 2010.

> Adjusted return on average shareholders' equity of 27.4% for 2011 exceeded 20% for the fourteenth consecutive year and 25% for the ninth consecutive year.

> Net interest income increased to $334.0 million, up $70.0 million or 26.5% over the $264.0 million earned in 2010, reflecting higher average loan balances of $15.4 billion compared to $11.8 billion in 2010 combined with stable combined net interest margin of 2.06% compared to 2.07% in 2010.

> Adjusted non-interest income was $37.3 million in 2011 compared to adjusted non-interest income of $47.0 million in 2010. In 2010 the Company recognized $3.9 million from the sale of a retail loan portfolio that did not reoccur in 2011 and recorded $9.7 million in net securities gains compared to $4.1 million in 2011. Fees and other income were up 23.8% to $38.0 million compared to $30.7 million in 2010, reflecting a greater number of fee bearing loans in 2011 compared to 2010.

> Provisions for credit losses were $7.5 million for the year, an improvement over the $9.4 million recorded last year. This represents 0.05% of gross loans, compared to 0.07% in 2010. Net write-offs were $10.7 million for 2011, representing 0.07% of gross loans compared to $5.7 million and 0.04% of gross loans in 2010. In 2011, the Company wrote off $2.0 million related to a fraud identified in a specific pool of Equityline *Visa* accounts. This loss was included in the provision established in 2010.

> Non-interest expenses, which include salaries, premises and other operating expense, were $105.0 million in 2011, up 9.9% over the $95.5 million recorded in 2010, reflecting business growth and measured and prudent investment in people, business development, infrastructure and technology. The Company's efficiency ratio (TEB) remains low at 27.9% compared to 29.3% in 2010, an indication of a high level of operating efficiency.

## Balance Sheet Highlights for 2011

> The Company's total assets increased 14.0% to reach $17.70 billion at the end of 2011 compared to $15.52 billion at the end of 2010.

> Mortgage originations were $5.12 billion in 2011 compared to the $6.87 billion originated in 2010. The Company scaled back lending in the Accelerator product while renewing focus on the traditional product, leading to a 23.2% increase to $3.51 billion in traditional originations compared to $2.85 billion last year. The Company continued to securitize insured mortgages as a source of funding and securitized $1.87 billion in 2011, including replacement assets for the CMB program, compared to $5.17 billion in 2010.

> The Company renewed its focus on the traditional product while maintaining the credit quality of the loan portfolio. Net non-performing loans as a percentage of the gross loans portfolio ended the year at 0.25% compared to 0.24% one year ago. At the end of 2011, 97.3% of the loan portfolio was current compared to 98.1% at the end of 2010.

> Liquid assets of Home Trust at December 31, 2011 were $763.3 million, compared to $951.3 million at December 31, 2010. The Company considers this a prudent level of liquidity, given the current level of operations and the Company's obligations.

> Home Trust's capital levels were strong throughout 2011, as indicated by the Tier 1 and Total capital ratios of 17.3% and 20.5%, respectively, at December 31, 2011, compared to 18.1% and 19.4%, at the end of 2010. Home Trust's ACM ended 2011 at 14.4. On May 4, 2011 the Company issued $150.0 million in long-term senior debt. Of the net proceeds, $100.0 million was provided to Home Trust as subordinated debt to enhance its regulatory capital position and support future growth. An additional $45.0 million was provided to Home Trust in early 2012 to further enhance its regulatory capital position and support growth objectives.

> Deposit and securitization liabilities at December 31, 2011 were $7.92 billion and $8.65 billion, respectively, compared to $6.60 billion and $8.10 billion, at December 31, 2010. Deposit liabilities grew more quickly than securitization liabilities as the traditional portfolio, which is typically funded with deposits, grew at a higher rate than the Accelerator portfolio, which is typically funded by way of securitization.

## FINANCIAL PERFORMANCE REVIEW

### Net Interest Income and Margin

Presented in the following tables is an analysis of average rates, net interest income and net interest margin. Net interest income is the difference between interest and dividends earned on loans and investments and the interest paid on deposits and borrowings to fund those assets. The net interest margin is net interest income divided by the Company's average total assets. Dividend income has been converted to a TEB (refer to the Non-GAAP Measures section of this report for a definition of TEB), for comparison purposes.

**Table 4: Net Interest Income and Margin**

| | | 2011 | | | 2010 | |
|---|---|---|---|---|---|---|
| (000s, except %) | Average Balance[1] | Income/ Expense | Average Rate[1] | Average Balance[1] | Income/ Expense | Average Rate[1] |
| **Assets** | | | | | | |
| Cash and cash resources | $ 483,055 | $ 3,386 | 0.70% | $ 449,385 | $ 5,337 | 0.83% |
| Securities | 425,241 | 20,161 | 4.74% | 644,750 | 22,673 | 3.54% |
| Non-securitized loans | 6,808,861 | 401,671 | 5.90% | 6,053,386 | 353,779 | 5.84% |
| Taxable equivalent adjustment | – | 7,212 | – | – | 7,900 | – |
| Total on non-securitized interest earning assets | 7,717,157 | 432,430 | 5.60% | 7,147,521 | 389,689 | 5.45% |
| Securitized loans | 8,568,643 | 330,491 | 3.86% | 5,721,393 | 251,292 | 4.39% |
| Other assets | 260,026 | – | – | 266,197 | – | – |
| **Total assets** | $ 16,545,826 | $ 762,921 | 4.61% | $ 13,135,111 | $ 640,981 | 4.88% |
| **Liabilities and shareholders' equity** | | | | | | |
| Deposits | $ 6,881,112 | $ 191,745 | 2.79% | $ 6,485,930 | $ 188,370 | 2.90% |
| Securitization liabilities | 8,594,613 | 224,719 | 2.63% | 5,732,510 | 180,681 | 3.16% |
| Other liabilities and shareholders' equity | 1,070,101 | 5,293 | 6.22% | 916,671 | – | – |
| **Total liabilities and shareholders' equity** | $ 16,545,826 | $ 421,757 | 2.55% | $ 13,135,111 | $ 369,051 | 2.81% |
| **Net interest income (TEB)** | | $ 341,164 | | | $ 271,930 | |
| **Tax equivalent adjustment** | | (7,212) | | | (7,900) | |
| **Net interest income per Financial Statements** | | $ 333,952 | | | $ 264,030 | |
| **Net interest margin non-securitized interest earning assets**[2] | | | 3.05% | | | 2.82% |
| **Net interest margin securitized assets** | | | 1.23% | | | 1.23% |
| **Total net interest margin**[2] | | | 2.06% | | | 2.07% |
| **Spread of non-securitized loans over deposits only** | | | 3.11% | | | 2.94% |

[1] The average rate is an average calculated with reference to opening and closing monthly asset and liability balances.

[2] Net interest margin is calculated on a TEB.

**Table 5: Interest Income and Average Rate by Loan Portfolio**

| (000s, except %) | 2011 Average Assets[1] | 2011 Interest Income | 2011 Average Rate[1] | 2010 Average Assets[1] | 2010 Interest Income | 2010 Average Rate[1] |
|---|---|---|---|---|---|---|
| Traditional single-family residential mortgages | **$ 4,957,419** | **$ 274,717** | **5.54%** | $ 3,825,038 | $ 231,964 | 6.06% |
| Accelerator single-family residential mortgages | **241,612** | **6,962** | **2.88%** | 806,647 | 20,844 | 2.58% |
| Multi-unit residential mortgages | **168,722** | **10,772** | **6.38%** | 256,361 | 11,944 | 4.66% |
| Securitized residential mortgages | **8,568,643** | **330,491** | **3.86%** | 5,721,393 | 251,292 | 4.39% |
| Non-residential mortgages | **925,022** | **59,182** | **6.40%** | 746,801 | 46,574 | 6.24% |
| Personal and credit card loans | **516,086** | **50,038** | **9.70%** | 418,539 | 42,453 | 10.14% |
| **Total average loans** | **$ 15,377,504** | **$ 732,162** | **4.76%** | $ 11,774,779 | $ 605,071 | 5.14% |

[1] The average is an average calculated with reference to opening and closing monthly balances.

Net interest income for 2011 increased 26.5% over 2010 reflecting an increase of $3.60 billion or 30.6% in average loan balances and relatively stable total net interest margin year-over-year.

Total net interest margin, including the securitized portfolio, was 2.06% for 2011 compared to 2.07% in 2010. While the total net interest margin has remained relatively stable year-over-year, the loan portfolio composition has shifted over the period as the Company's strategy was to shift relative focus from Accelerator products in 2010 to traditional products in 2011. As such, over the period the portfolio weighting of securitized mortgages and pledged assets, which earn a lower net interest margin, increased from 42.8% at January 1, 2010 to 57.6% at December 31, 2010 and then declined to 52.3% at December 31, 2011.

The net interest margin on non-securitized assets improved to 3.05% from 2.82% in 2010. The overall average yield earned on the non-securitized loan portfolio increased six basis points over 2010, reflecting the improved average rates and higher balances in the non-residential portfolio and increased average rates in the multi-unit residential portfolios. This was partially offset by continued low Government of Canada bond yields that have contributed to lower rates in the fixed-rate mortgage market and a decline in average rates on the traditional portfolio. Lower Government of Canada bond yields also led to a drop of 11 basis points in the Company's average deposit rates compared to 2010. The Company's strategy is to manage the spread of deposits to traditional mortgages in the range of 3.0%. Average rates on the securities portfolio have also improved as the Company rebalanced the investment and liquidity portfolio and focused on improving margins.

The net interest margin on securitized assets has remained stable year-over-year with moderate fluctuations during the year. A decline in the average rate earned on the securitized assets was offset by a decline in the securitization liability average rate. The reduction in the securitization liabilities average rate was due to lower securitization funding rates over the latter half of 2010, including variable rate funding, and the accounting classifications resulting from the application of hedge accounting to interest rate swaps in 2011, which lowered average funding costs compared to 2010. The lower average rate earned on securitized assets reflects the combination of a higher proportion of variable rate mortgages securitized later in 2010 and the maturity of mortgages earning higher rates.

Accelerator mortgages include fewer variable rate mortgages compared to comparative periods thus increasing the average rate for this portfolio. The Company generally holds these mortgages for new securitizations or replacement assets for the CMB.

The average rate earned on the personal and credit card portfolio is 44 basis points lower than in 2010, reflecting the Company's expanded offering of Equityline *Visa* credit cards at lower rates to customers with higher credit scores. Increases in the fully secured water heater receivables in the retail lending portfolio at lower average rates also lowered the overall rate on the portfolio. At the same time, average assets increased over the period leading to higher interest income from these products.

### 2012 Outlook for Net Interest Income

The Company expects net interest income to grow relative to loan portfolio growth in 2012. The Company will continue to prudently employ its growth strategy for the traditional mortgage, which should continue to favourably influence net interest income in 2012. Tempering this influence on net interest income will be the continued high proportion of insured securitized mortgages, which have lower interest margins.

The Company expects net interest margin on non-securitized assets to remain relatively stable at 2011 levels into 2012, reflecting the strategy to manage the spread between deposits and traditional mortgages at approximately 3.0%. Modest increases may emerge in 2012 if additional non-residential and/or store and apartment loans within the Company's risk profile and appetite become available.

The Company anticipates a modest decline in net interest margin on the securitized portfolio in 2012 compared to 2011 with rates consistent with those realized in the fourth quarter of 2011. The decline primarily reflects a combination of two factors: spreads on new securitization transactions are generally lower than the spreads earned on the maturing pools and are lower than the spreads earned on the 2008 and 2009 securitization transactions; and the assets provided as replacement assets in the CMB program are generally lower yielding when compared to the maturing or discharging assets. While the Company actively hedges the CMB reinvestment risk, the hedges cannot absorb 100% of this risk. This dynamic will tend to put pressure on the overall net interest margin. The increased weighting of the Company's traditional uninsured mortgages tends to offset this downward pressure, as the margins on these products are more favourable.

The Company continually reviews pricing, funding costs and product structures to maximize spread returns, including diversification and growth of the consumer lending segment. The Company will continue to balance prudent liquidity with investment return options to optimize the risk/return relationship while considering economic and credit conditions.

### Non-interest Income

**Table 6: Non-Interest Income**

| (000s, except %) | | 2011 | | 2010 | Change |
|---|---|---|---|---|---|
| Fees and other income | $ | **37,997** | $ | 30,690 | 23.8% |
| Gain on sale of loan portfolio | | **–** | | 3,917 | (100.0%) |
| Realized net gains and unrealized losses on securities | | **4,088** | | 9,740 | (58.0%) |
| Net realized and unrealized (loss) gain on derivatives | | **(7,203)** | | 9,821 | (173.3%) |
| Total non-interest income | $ | **34,882** | $ | 54,168 | (35.6%) |

Fees and other income include mortgage and *Visa* account administration fees, net of direct servicing expenses, and generally increase as the size of the loan portfolio increases. Fee income is also influenced by the overall mix of the portfolio and has grown at a slightly faster pace than the overall loan portfolio growth due to the focus on the Company's traditional mortgage portfolio.

The Company recognized a net gain of $7.1 million on the sale of certain available for sale securities in 2011, compared to $10.2 million in 2010. The Company takes advantage of improvements in securities markets and will rebalance the investment portfolio as market conditions warrant. The Company also recognized $3.0 million in impairments through profit and loss on certain available for sale equity securities in 2011 compared $0.4 million in 2010.

Net realized and unrealized (loss) gain on derivatives includes net losses due to hedge ineffectiveness of $0.2 million on the Company's fair value and cash flow interest rate hedges (please see the Derivatives and Hedging section of this MD&A for further discussion). This category also includes $3.6 million in unrealized losses for fair value changes in interest rate swaps that are not designated in hedge accounting relationships. On an economic basis, these losses are offset by gains in the fair value of other net assets, but such gains are not recorded through profit and loss. The Company expects that the amount and direction of fair value adjustments will vary from quarter to quarter. Management closely monitors the fair value changes. The Company did not apply hedge accounting in 2010 and therefore the 2010 derivatives gains (losses) amounts reflect the fair value changes of the derivative positions without offset for hedged items.

In January 2011 the Company restructured certain derivative positions to achieve hedge accounting under IFRS. While the Company designated the restructured interest rate swaps and bond forwards in hedge accounting relationships from the restructure date forward, in the period prior to designation the Company recognized an unrealized pre-tax loss of $3.3 million. This amount is adjusted from net income for performance measurement purposes. In 2010 the Company was not applying hedge accounting to its hedges of interest rate risk and, as such, all of the unrealized fair value gains and losses on derivatives were recorded through income as they occurred and are also adjusted from net income for performance measurement purposes in 2010.

### 2012 Outlook for Non-interest Income

The Company anticipates that fees and other income will grow over the 2011 levels as the Company continues to prudently continue focus on the traditional mortgage portfolio. The Company expects to launch a complementary business strategy in 2012 that will focus on a new source of fee revenue from loan origination and administration for other mortgage funders through the sale of fully insured mortgages. That activity is anticipated to increase non-interest income in 2012.

The Company will continue to hedge its interest rate risk, associated with the loan commitments and replacement assets, through the use of bond forward contracts and interest rate swaps. The Company expects to continue to apply hedge accounting to such instruments, thus reducing earnings volatility from derivatives gains and losses.

### Non-interest Expenses

**Table 7 – Non-interest Expenses**

| (000s, except %) | 2011 | 2010 | Change |
|---|---|---|---|
| **Salaries and employee benefits** | $ 52,523 | $ 46,739 | 12.4% |
| **Premises and equipment** | | | |
| Rent – premises | 5,455 | 4,789 | 13.9% |
| Equipment rental and repairs | 2,321 | 2,105 | 10.3% |
| | 7,776 | 6,894 | 12.8% |
| **Other operating expenses** | | | |
| Consulting and other professional services | 12,135 | 10,555 | 15.0% |
| Capital taxes and insurance | 2,311 | 4,307 | (46.3%) |
| Outside services | 8,978 | 7,058 | 27.2% |
| Depreciation and amortization | 3,731 | 3,215 | 16.0% |
| Other | 4,331 | 5,494 | (21.2%) |
| Computer services | 4,874 | 4,804 | 1.5% |
| Advertising and business development | 4,532 | 3,254 | 39.3% |
| Stationery and publications | 2,231 | 1,702 | 31.1% |
| Communications and travel expenses | 1,580 | 1,454 | 8.7% |
| | 44,703 | 41,843 | 6.8% |
| **Total non-interest expenses** | $ 105,002 | $ 95,476 | 10.0% |
| Average balance sheet assets | $ 16,545,826 | $ 13,135,111 | |
| **As a % of balance sheet assets** | 0.63% | 0.73% | |
| **Efficiency ratio** | | | |
| Net interest income | $ 333,952 | $ 264,030 | |
| Other income | 34,882 | 54,168 | |
| Total revenue, net of interest expense | 368,834 | 318,198 | |
| TEB adjustment | 7,212 | 7,900 | |
| Total revenue TEB, net of interest expense | $ 376,046 | $ 326,098 | |
| As a % of total revenue, net of interest expense | 28.5% | 30.0% | |
| As a % of total revenue TEB, net of interest expense | 27.9% | 29.3% | |
| Target efficiency ratio TEB | 28.0%–34.0% | 28.0%–34.0% | |

The Company continued to operate at a low efficiency ratio in 2011 and below the 2011 target range, reflecting continued low costs compared to revenues net of interest expense. Non-interest expense as a percentage of balance sheet assets declined year over year indicating improved efficiency in administering assets. The Company continues to manage expenses in a disciplined and measured manner and aligns its expense management strategy with its growth targets and strategic objectives. While carefully managing costs, the Company continues to increase its investment in risk management techniques and human resources, adding to the enterprise risk management, internal audit and compliance functions.

The Company reached a significant milestone in 2011 and completed the implementation of the new core banking system. To take advantage of the new functionality and anticipated efficiencies of the new core system, the Company launched a centralized operations group and an organizational effectiveness initiative. The new group and initiative will continue to foster business growth and superior customer service, while driving improved operational discipline and cost management, supporting the Company's strategic objectives.

Outside services includes outside sales costs associated with the consumer lending segment and has grown in line with growth in this segment.

During the year the Company increased non-employee spending primarily on outsourcing services and consulting services associated with the implementation of the new core banking system and projects associated with improvements to the Company's governance, risk and compliance functions. The increase in employee-related expenditures year over year reflects staffing mix changes, merit increases and increased overtime related to the implementation of the new core banking system. At the end of 2011 the Company employed 554 staff, compared to 560 staff one year ago.

### 2012 Outlook for Non-interest Expenses

One of the Company's strategic objectives is to improve systems and processes to allow the Company's revenue to continue growing, without equivalent increases in the rate of increases in expenses. The year 2011 was a year of significant expenditures on improvements to IT systems and processes and to governance and control functions. Improvement to IT systems and processes, along with further strengthening of governance, risk and compliance functions, will continue into 2012, along with moderate additions to human resources.

Amortization of capitalized development costs associated with the core banking system commenced in late 2011. The Company will amortize these costs over the expected life of the system, which is 10 years. The Company expects that the amortization expense will be partially offset by improved efficiencies over time and increased revenue, allowing for continued low efficiency ratio within the Company's target range of 28.0%–34.0%.

### Provision and Allowance for Credit Losses

**Table 8: Provision for Credit Losses**

| (000s, except % and basis points (bp)) | **2011** | 2010 | Change |
|---|---|---|---|
| Collective provision | **$ 287** | $ 1,360 | (78.9%) |
| Individual provision | **7,232** | 8,071 | (10.4%) |
| Total provision | **$ 7,519** | $ 9,431 | (20.3%) |
| Provision as % of gross loans | **0.05%** | 0.07% | (2 bp) |
| Net write-offs | **$ 10,673** | $ 5,733 | 86.2% |
| Net write-offs as % of gross loans | **0.07%** | 0.04% | 3 bp |

**Table 9: Net Non-Performing Loans & Allowances**

| (000s, except % and basis points (bp)) | **2011** | 2010 | Change |
|---|---|---|---|
| Net non-performing loans | **$ 40,297** | $ 34,225 | 17.7% |
| Gross loans | **16,091,162** | 14,096,652 | 14.1% |
| Net non-performing loans as % of gross loans | **0.25%** | 0.24% | 1 bp |
| Collective allowance | **$ 29,440** | $ 29,153 | 1.0% |
| Individual allowance | **1,859** | 5,300 | (64.9%) |
| **Total allowance** | **$ 31,299** | $ 34,453 | (9.2%) |

The provision for credit losses is charged to the income statement by an amount that brings the individual and collective allowances for credit losses to the level determined by management to be adequate to cover incurred losses, including losses that are not yet individually identified. Factors that influence the provisions for credit losses include the formation of new non-performing loans; the level of write-offs; and management's assessment of the level of collective and individual allowances required based on available data, including current and historical credit performance of the portfolio, external economic factors, the composition of the portfolio, and the overall growth in the loans portfolio.

Provision as a percentage of gross loans of 0.05% is within the target range of 0.05% to 0.15% and below the 0.07% recorded in 2010, due to declines in both the individual and collective provisions. The year-over-year decline in the individual provision and allowance reflects the strong credit quality of the loan portfolio and is indicative of prudent and conservative credit and portfolio management. Net write-offs in 2011 were affected by a fraud in an isolated pool of Equityline *Visa* accounts where the Company wrote off $2.0 million. In 2010, the Company experienced a higher than expected level of recoveries reducing net write-offs. Net write-offs in 2011 are within expected low levels.

During 2011, the Company became aware of alleged irregularities regarding three of its loans with a total principal amount of $4.6 million. These loans were advanced to two Toronto residential condominium corporations. The registered security documents associated with these loans provide the Company with a secured priority claim against the condominium corporation, the condominium structure and the underlying residential units. Provided that the security is valid, the Company would expect to recover any losses on such loans. The borrowers are disputing the validity of the Company's security in the Ontario Court. It is not currently possible to reasonably determine the outcome of this matter or to estimate the amount of loss, if any. A specific provision has not been recorded for these loans but these loans have been classified as non-performing residential loans.

Net non-performing loans as a percentage of gross loans increased marginally by one basis point. Much of the dollar increase in net non-performing loans is attributed to the $4.6 million in irregularities noted above. The remaining change relates to the timing of the resolution of properties in possession.

The collective allowance balance at December 31, 2011 increased marginally over December 31, 2010. The Company continues to observe strong credit performance in the loans portfolio as reflected in the following factors:

> A relatively low rate of non-performing loans. Credit losses and non-performing loans are within the range of the Company's historical averages. The Company continues to employ prudent strategies to maintain the credit quality of the loans portfolio.

> Stable real estate markets, overall net write-offs within expected lower ranges and a continued and focused effort at working out non-performing loans. Gross write-offs in the residential mortgage portfolio are consistent with the Company's expectations and experience over the long term. Personal and credit card loan portfolio write-offs are within expected levels. The Company's ongoing risk management philosophy includes close monitoring of non-performing loans and the employment of proactive measures to minimize losses, as described in the Credit Risk section of this MD&A.

### 2012 Outlook for Provision for Credit Losses

The Company's provision for credit losses in 2012 will be influenced by the strength of the Canadian economy and the resulting impact on employment and housing markets. There remains uncertainty related to unemployment and the growth prospects for certain sectors of the economy reflecting continued uncertainty in international markets; however, the Company continues to expect housing markets in most of the country to remain relatively stable in 2012. The Company also expects that Canadian consumers will continue to service and manage debt levels. While the Company is cautiously optimistic that credit losses will remain stable, it is prepared for volatility in this trend.

The Company's 2012 objective is that the provision for credit losses be between 0.05% and 0.15% of total loans. Specific allowances will continue to be determined and reviewed monthly on an account-by-account basis. The collective allowance for credit losses reflects an ongoing assessment of the strength of the portfolio at any given time, which will continue to be reviewed at least on a quarterly basis.

### Taxes

**Table 10: Income Taxes**

| (000s, except %) | | 2011 | | 2010 | Change |
|---|---|---|---|---|---|
| Current | $ | **66,270** | $ | 35,231 | 88.1% |
| Deferred | | **(37)** | | 23,308 | (100.2%) |
| Total income taxes | | **66,233** | | 58,539 | 13.1% |
| **Effective income tax rate** | **$** | **25.84%** | $ | 27.45% | |

The provision for income taxes for 2011 amounted to $66.2 million for an effective tax rate of 25.8% compared to $58.5 million in 2010 and an effective rate of 27.5%. These effective rates are lower than the legislated federal and provincial rates primarily due to tax-exempt dividend income and lower tax rates on the recognition of future timing differences. The decline in the effective rate from 2010 to 2011 primarily reflects a proportionate decline in statutory rates.

The Company has capital losses of $2.8 million ($2.8 million in 2010), which are available to reduce capital gains in future years and have no expiry date. The Company has not recognized the tax benefit of these capital losses.

Note 16 to the consolidated financial statements included in this report provides more information about the Company's current income taxes, deferred income taxes, and provisions for income taxes.

### 2012 Outlook for Taxes

The Company expects the effective income tax rate in 2012 to be within the range of 25.0% to 26.2%, based on lower federal and Ontario statutory rates, as well as tax-exempt dividend income. Capital tax expense is expected to decrease significantly in 2012, as Ontario and British Columbia capital tax is eliminated.

### Comprehensive Income

**Table 11: Comprehensive Income**

| (000s, except %) | 2011 | 2010 | Change |
|---|---|---|---|
| Net income | $ 190,080 | $ 154,752 | 22.8% |
| Net unrealized (losses) gains on securities available for sale, net of reclassifications to net income and taxes | (10,047) | (4,299) | 133.7% |
| Net unrealized losses on cash flow hedges, net of reclassifications to net income and taxes | (5,050) | – | – |
| Total other comprehensive (loss) income | (15,097) | (4,299) | 251.2% |
| **Comprehensive income** | $ 174,983 | $ 150,453 | 16.3% |

Comprehensive income is the aggregate of net income and other comprehensive income (OCI). OCI includes changes in unrealized gains or losses on available for sale securities, transfers of previously unrealized net gains and losses to net income, once they have been realized, and the impact of cash flow hedges and transfers to income of unrealized losses on investments considered impaired.

The Company recognized transfers to net income of $4.8 million in net gains in 2011 compared to $8.5 million in net gains in 2010 related to the sale of certain available for sale securities. Additionally, the Company recognized transfers to net income of net losses of $3.0 million in 2011 and $0.4 million in 2010 related to impairment of available for sale securities. OCI included $8.6 million in unrealized losses in 2011 and $3.2 million in unrealized gains associated with changes in the fair value of available for sale securities.

OCI included $7.4 million in net losses related to cash flow hedges in 2011 which are deferred from recognition in income until the hedged cash flows occur. The Company transferred $0.6 million in previously recorded losses to net income in 2011 related to the amortization of cash flow hedges. The Company did not apply cash flow hedging in 2010. (Please refer to the Derivatives and Hedging section of this MD&A and Note 19 to the consolidated financial statements for additional information about the Company's cash flow hedging programs.)

## FINANCIAL POSITION REVIEW

### Table 12: Balance Sheet Accounts

The table below presents the balance sheet position of the Company at December 31, 2011 and December 31, 2010, along with percent changes.

| (000s, except %) | **2011** | 2010 | Change |
|---|---|---|---|
| Cash resources | **$ 665,806** | $ 846,824 | (21.4%) |
| Available for sale securities | **391,754** | 424,168 | (7.6%) |
| Pledged securities | **341,588** | 2,954 | 11,463.6% |
| Total cash resources and securities | **1,399,148** | 1,273,946 | 9.8% |
| Loans | | | |
| Residential mortgages | **6,339,883** | 4,683,527 | 35.4% |
| Securitized residential mortgages | **8,243,350** | 8,116,636 | 1.6% |
| Non-residential mortgages | **946,222** | 838,253 | 12.9% |
| Personal and credit card loans | **560,193** | 453,339 | 23.6% |
| Total loans | **16,089,648** | 14,091,755 | 14.2% |
| Collective allowance for credit losses | **(29,440)** | (29,153) | 1.0% |
| | **16,060,208** | 14,062,602 | 14.2% |
| Other assets | **237,115** | 182,270 | 30.1% |
| Total assets | **$ 17,696,471** | $ 15,518,818 | 14.0% |
| Deposits | **$ 7,922,124** | $ 6,595,979 | 20.1% |
| Senior debt | **153,336** | – | – |
| Securitization liabilities | **8,649,075** | 8,104,578 | 6.7% |
| | **16,724,535** | 14,700,557 | 13.8% |
| Other liabilities | **197,151** | 189,676 | 3.9% |
| Total liabilities | **16,921,686** | 14,890,233 | 13.6% |
| Shareholders' equity | **774,785** | 628,585 | 23.3% |
| Total liabilities and shareholders' equity | **$ 17,696,471** | $ 15,518,818 | 14.0% |
| Cash resources and securities as a % of total assets | **7.9%** | 8.2% | |
| Loans as a % of total assets | **90.8%** | 90.6% | |

**Table 13: Liquidity Resources (Home Trust)**

| (000s, except %) | 2011 | 2010 | Change |
|---|---|---|---|
| Total cash resources and securities per balance sheet | **$ 1,399,148** | $ 1,273,946 | 9.8% |
| Add: MBS included in residential mortgages | **260,572** | 114,732 | 127.1% |
| Total cash and investments | **1,659,720** | 1,388,678 | 19.5% |
| Less: securities held for investments | **(378,498)** | (322,536) | 17.4% |
| Less: restricted cash | **(101,753)** | (95,882) | 6.1% |
| Less: pledged assets | **(341,588)** | (2,954) | 11,463.6% |
| Less: cash held by Home Capital | **(74,602)** | (16,035) | 365.2% |
| Liquidity held by Home Trust | **$ 763,279** | $ 951,271 | (19.8%) |

### Cash Resources and Securities

Combined cash resources and securities as at December 31, 2011 increased by $125.2 million compared to December 31, 2010. In addition to cash and securities, the Company maintains prudent liquidity by investing a portion of the liquidity assets in Company originated MBS. These securities are classified as residential mortgages on the balance sheet, as required by GAAP.

Included in cash resources is $101.8 million in restricted cash ($95.9 million in 2010). Restricted cash includes amounts pledged as collateral for the Company's securitization activities and interest rate swaps used in the CMB program, as well as reserve accounts associated with the retail lending portfolio.

The securities portfolio has increased by $306.2 million since December 31, 2010. The portfolio includes $341.6 million of assets pledged under the CMB program as replacement assets compared to $3.0 million at December 31, 2010 representing 46.6% of the Company's securities in 2011 (0.7% in 2010). These assets include treasury bills and third party insured MBS.

In addition to the securities pledged under the CMB program, the securities portfolio consists of bonds, common and preferred shares and mutual funds. At December 31, 2011, the preferred share portfolio was $368.5 million or 50.2% of the Company's securities compared to 72.4% in 2010. Investment grade preferred shares represent 65.5% of the preferred share portfolio (66.9% in 2010). Bonds, common shares and mutual funds combined represent 3.2% of the Company's securities compared to 25.8% in 2010.

The Company continues to invest in conservative assets while seeking appropriate returns. During the year, the Company took advantage of market opportunities and sold certain securities, realizing a net pre-tax gain of $7.1 million compared to $10.2 million during 2010.

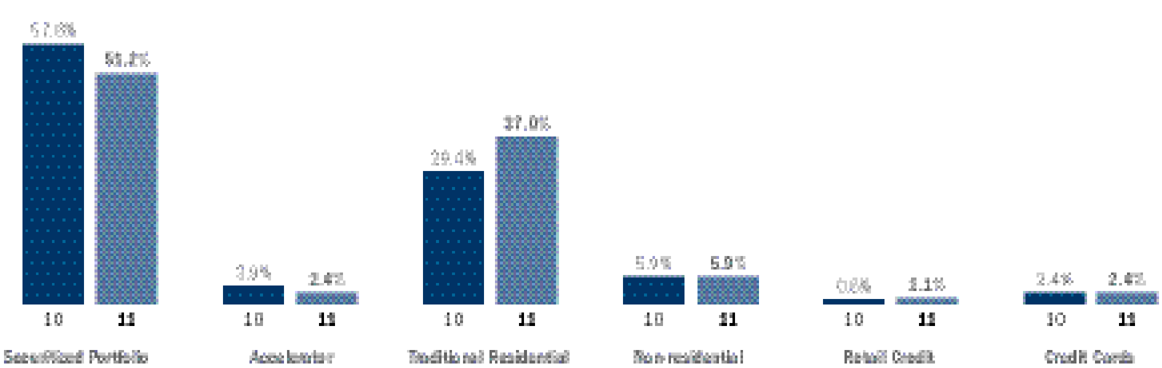
Additional details related to the Company's securities portfolio can be found in Note 4 to the consolidated financial statements included in this report.

### 2012 Outlook for Cash Resources and Securities

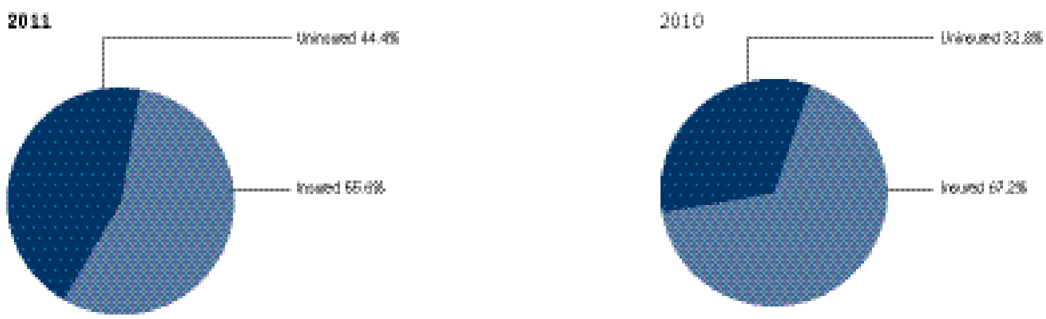
The Company will continue to target a conservative level of liquid assets while maintaining financial flexibility. The securities portfolio should increase in line with growth in total assets. A significant proportion of excess funds arising through the Company's retail deposits channel and securitization activities will be deployed into short-term, highly liquid investments while management continues to invest the balance in securities that provide attractive returns.

### Loans Portfolio

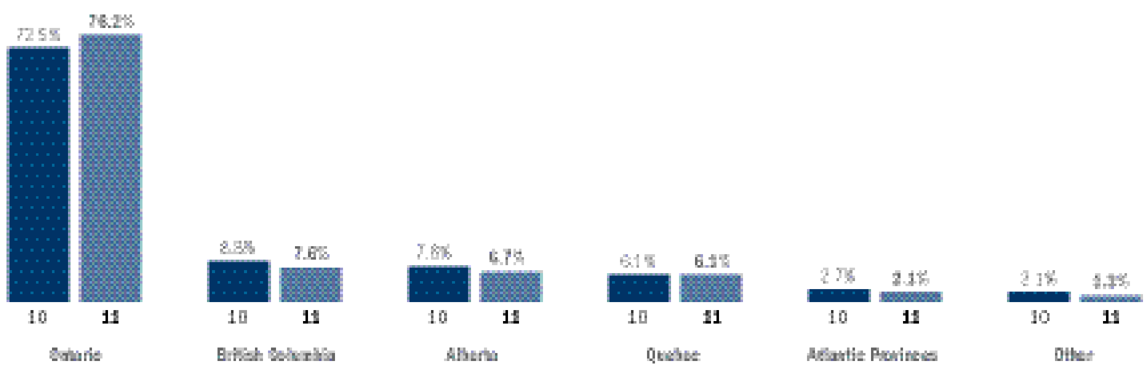
**Figure 1: Portfolio Composition by Product Type**



## Figure 2: Insured versus Uninsured Mortgages




## Figure 3: Portfolio Composition by Province




The Company's loans portfolio consists of traditional residential, Accelerator residential, securitized residential and non-residential mortgages, credit cards and retail credit loans. At December 31, 2011 the loans portfolio amounted to $16.09 billion, up $2.00 billion or 14.2% over the $14.09 billion at December 31, 2010. Much of the loans portfolio growth was in the traditional mortgage portfolio consistent with the Company's strategy to increase focus on this more profitable residential portfolio.

As illustrated in the previous charts, the Company's residential lending continues to represent the most significant component of the Company's loans portfolio, at 90.6% of the total portfolio, compared to 90.9% in 2010. Insured mortgages continued to be a significant component of the Company's mortgage portfolio in 2011, although the proportion has declined from 2010. This is consistent with the Company's strategy to increase focus on traditional mortgages, which are generally uninsured. The increase in uninsured mortgages has not translated to increased credit losses on a proportionate basis. (Please see the Provisions and Allowance for Credit Losses and Credit Risk sections of this MD&A for further discussion.)

The securitized mortgage portfolio grew 1.6% in 2011 compared to record growth in 2010. The regulatory and accounting treatment of Accelerator (insured) securitized mortgages, upon adoption of IFRS, introduced new capital constraints and effectively increased the cost of capital allocated to Accelerator and securitized mortgages. Consequently, the Company scaled back lending in this segment. The Company continues to explore opportunities that may ultimately lead to future growth in the Accelerator and securitized mortgage portfolio. The current regulatory treatment of insured mortgages tends to constrain the growth that would otherwise be available.

The traditional mortgage portfolio increased by 35.4% to $6.34 billion from $4.68 billion at the end of 2010, supported by the Company's strategy to increase focus on this portfolio which has been the Company's core business. Credit losses experienced in 2011 on the portfolio are consistent with the Company's historical experience. The Company focused the portfolio's growth in its traditional target markets and employed additional prudence in certain areas where the housing and employment markets were relatively weaker.

The non-residential mortgage portfolio increased by 12.9% to $946.2 million from $838.3 million at the end of 2010. The Company continues to prudently increase the loan balances in this segment while maintaining its relative proportion of the total loan portfolio. In prior years the Company reduced the portfolio in light of market uncertainty. The Company will continue to manage this portfolio in a conservative manner and grow the portfolio when assets of appropriate quality within the Company's risk appetite are available. Included in the non-residential category are store and apartment structures, office buildings, residential and non-residential construction, retail stores, hotels and industrial properties.

The credit card loan portfolio increased by 14.8% to $387.0 million from $339.9 million at the end of 2010, reflecting the Company's strategy to grow its Equityline *Visa* program through cross-selling to mortgage customers and development through brokers.

The Company's retail credit portfolio continues to be an integral part of the loans portfolio generating above average returns for the Company. The portfolio increased by 49.1% to $173.3 million from $116.2 million at the end of 2010. Water heater loans, a loan financing product introduced in 2010, are the largest component of the retail lending portfolio, amounting to $152.6 million or 88.1% of the loans outstanding at the end of 2011. The average size of a water heater loan is approximately $1000.

The Company, through past expansion, provides mortgages and loans across Canada. The Company continues to prudently re-enter certain of its previous markets outside Ontario, as well as entering new markets within Ontario, in order to facilitate expansion plans intended to expand its geographic footprint. The Company's lending activities remained concentrated in the Ontario market in 2011 but included expansion into new Ontario markets. The reduction of loan exposures in western Canada reflect the Company's assessment of and response to weakening credit conditions that developed late in 2010 and into 2011. The Company continues to employ strategies to increase its geographic diversification while remaining responsive to local economic conditions.

**Table 14: Mortgage Loan Advances by Type and Province**

| (000s, except %) | 2011 | % of Total | 2010 | % of Total | Change |
|---|---|---|---|---|---|
| Traditional single-family residential mortgages | $ 3,514,430 | 68.6% | $ 2,853,385 | 41.5% | 23.2% |
| Accelerator single-family residential mortgages | 1,103,555 | 21.6% | 2,839,394 | 41.3% | (61.1%) |
| Multi-unit residential mortgages | 137,005 | 2.7% | 766,483 | 11.2% | (82.1%) |
| Non-residential mortgages | 182,163 | 3.6% | 219,760 | 3.2% | (17.1%) |
| Store and apartments | 122,957 | 2.4% | 108,769 | 1.6% | 13.0% |
| Warehouse commercial mortgages | 56,750 | 1.1% | 80,800 | 1.2% | (29.8%) |
| Total mortgage advances during the year | $ 5,116,860 | 100.0% | $ 6,868,591 | 100.0% | (25.5%) |

| (000s, except %) | 2011 | % of Total | 2010 | % of Total | Change |
|---|---|---|---|---|---|
| British Columbia | $ 234,229 | 4.6% | $ 542,518 | 7.9% | (56.8%) |
| Alberta | 176,957 | 3.5% | 371,143 | 5.4% | (52.3%) |
| Ontario | 4,400,136 | 85.9% | 5,278,029 | 76.9% | (16.6%) |
| Quebec | 230,474 | 4.5% | 334,568 | 4.9% | (31.1%) |
| Atlantic provinces | 70,800 | 1.4% | 222,944 | 3.2% | (68.2%) |
| Other | 4,264 | 0.1% | 119,389 | 1.7% | (96.4%) |
| Total mortgage advances during the year | $ 5,116,860 | 100.0% | $ 6,868,591 | 100.0% | (25.5%) |

New mortgage production was weighted to the Company's traditional single-family loans reflecting the focus on higher margin products within the Company's risk appetite. Non-residential and store and apartment originations remained an important complementary source of loan assets with attractive returns in 2011. The Company prudently increases these portfolios when quality assets meeting the Company's risk appetite are available.

Mortgage production continued to favor Ontario in 2011 given the Company's assessment of credit risks.

**Table 15: Consumer Lending Production**

| (Amount in 000s) | 2011 | | 2010 | | Change | |
|---|---|---|---|---|---|---|
| | **Number of New Accounts** | **Amount[1]** | Number of New Accounts | Amount[1] | Number of New Accounts | Amount[1] |
| *Visa* | **9,065** | **$ 204,095** | 6,890 | $ 189,423 | 31.6% | 7.7% |
| Water heaters | **46,223** | **56,689** | 83,106 | 77,557 | (44.4%) | (26.9%) |
| Other retail lending | **799** | **3,023** | 507 | 2,474 | 57.6% | 22.2% |

[1] For *Visa*, the amount represents the authorized credit limits. For water heaters and other retail lending, the amount represents the loan balances outstanding.

The Company's consumer lending portfolio includes credit card and retail lending.

Equityline *Visa*, which is fully secured by residential real estate, is the largest component of the *Visa* portfolio, representing 97.8% of total credit card loans. The Company's "one-stop" bundled mortgage product, which bundles a first mortgage with an Equityline *Visa*, combined with other marketing initiatives in 2011, led to the significant increase in the number of new *Visa* accounts compared to 2010.

The largest component of retail lending is water heater loans, representing 88.1% of the portfolio. The Company introduced this line of business in 2010. The large growth in 2010 reflects the acquisition of the initial portfolio. The Company is pleased with the growth of this line of business in 2011, which offers an attractive rate of return with little credit risk.

### 2012 Outlook for Loan Portfolios

The Company expects that the rate of growth in the Company's funded loan portfolio in 2012 will be consistent with the pace of growth experienced in 2011. The shift towards the traditional mortgage business is expected to continue into 2012 with growth rates moderating in this portfolio as the Company achieves the balance in the portfolios to support sustained growth in earnings and returns on equity. The Company will continue to offer insured mortgages through the Accelerator program, supporting the "one–stop" and "flexible lending solutions" lender strategy. The Company also expects to launch a complementary business strategy in 2012 that will focus on originations and mortgage administration for other mortgage funders that may moderately increase insured mortgages under administration. The Company will also continue to increase its geographic expansion, taking advantage of opportunities within its risk profile in Quebec, and eastern and western Canada.

Non-residential mortgages are expected to grow at a pace consistent with 2011 to maintain the overall proportion in the total portfolio, if appropriate assets with attractive returns within the Company's risk appetite are available in the market.

Growth of the consumer loan portfolio at the current rate is expected for 2012. The Equityline *Visa* credit card portfolio will continue to be the primary contributor to the credit card loan portfolio supported by both the "one stop" bundled mortgage and marketing efforts. The Company anticipates continued measured growth in the water heater line of business and is currently exploring this channel for other opportunities. The Company expects growth rates in the retail portfolio to be consistent to moderately higher when compared to 2011.

### Deposits, Senior Debt and Securitization Liabilities

**Table 16: Deposits, Senior Debt and Securitization Liabilities**

| (000s, except %) | 2011 | 2010 | Change |
|---|---|---|---|
| Deposits payable on demand | **$ 62,746** | $ 50,359 | 24.6% |
| Deposits payable on fixed dates | | | |
| Debenture investment certificates | **6,897,351** | 5,726,583 | 20.4% |
| Short-term certificates and savings | **656,803** | 553,793 | 18.6% |
| Registered retirement savings plans | **162,274** | 150,030 | 8.2% |
| Registered retirement income funds | **98,896** | 83,414 | 18.6% |
| Tax Free Savings Accounts | **30,835** | 19,662 | 56.8% |
| *Visa* card security deposits | **13,219** | 12,138 | 8.9% |
| | **7,859,378** | 6,545,620 | 20.1% |
| Senior debt | **153,336** | – | – |
| Securitization liabilities | | | |
| Mortgage-backed security liabilities | **2,417,801** | 2,826,105 | (14.4%) |
| Canada Mortgage Bond liabilities | **6,231,274** | 5,278,473 | 18.1% |
| | **8,649,075** | 8,104,578 | 6.7% |
| **Total** | **$ 16,724,535** | $ 14,700,557 | 13.8% |

In May 2011 the Company issued $150.0 million in senior debt into the bond market, using $100 million to purchase subordinated debt of Home Trust and thus increasing its regulatory capital. (Please see the Capital Management section of this MD&A and Notes 12 and 14 to the consolidated financial statements for further discussion.)

The Company's securitization liabilities increased over 2010 as the Company funded insured mortgages through the CMB program. The Company did not utilize the National Housing Authority (NHA) MBS market outside the CMB program as the rates were more favourable through the CMB program. As such, the MBS liabilities declined compared to 2010 as outstanding MBS amortized. The Company securitized $2.22 billion in 2011, compared to $5.17 billion in 2010. The securitization amounts include mortgages and other eligible assets that are used as replacement assets in the CMB program, which amounts do not result in a net increase in the securitization liability. The average coupon on new securitization liabilities was 2.0% in 2011, compared to 1.9% in 2010. The average yield on the mortgages securitized was 3.8% in 2011 compared to 3.6% in 2010.

Deposits increased primarily to provide a significant portion of the funding for the non-securitized loan portfolio. Due to the shift in focus to traditional mortgages, which are generally deposit-funded, deposit levels increased year over year. The Company's deposit portfolio primarily comprises fixed term deposits, which represent 99.2% of all deposits, thereby reducing the risk of untimely withdrawal of funds by retail clients. Further, the Company's deposit portfolio comprises deposits solely from retail investors; the Company does not raise deposits through the wholesale market. (Please see Note 11 to the consolidated financial statements included in this report for a breakdown by maturity and yield of the Company's deposit portfolio.)

### 2012 Outlook for Deposits and Securitization Liabilities

The Company will continue to source deposits from the public through investment dealers and deposit brokers while seeking to expand this network through agreements with additional deposit brokers that meet the Company's selection criteria and through additional products that meet the requirements for CDIC coverage. The rate of growth of the deposit portfolio is expected to mirror the growth that is required to support the Company's traditional loan portfolio, while securitization will continue to support the current stock of insured mortgages. New originations and renewals of insured mortgages will be funded by securitization or packaged for sale to other funders through the Company's development of a complementary strategy to provide mortgage origination and administration services for other funders. Ensuring that there is a reliable and sufficient source of deposits to fund operations and liquidity reserves will remain a key objective for the Company.

### Other Assets and Liabilities

**Table 17: Other Assets and Liabilities**

| (000s, except %) | 2011 | 2010 | Change |
|---|---|---|---|
| Other assets | | | |
| Income taxes receivable | $ – | $ 9,451 | (100.0%) |
| Derivative assets | 72,424 | 24,157 | 199.8% |
| Accrued interest receivable and prepaid assets | 79,650 | 80,099 | (0.6%) |
| Capital assets | 5,372 | 4,894 | 9.8% |
| Intangible assets | 63,917 | 47,917 | 33.4% |
| Goodwill | 15,752 | 15,752 | – |
| | $ 237,115 | $ 182,270 | 30.1% |
| Other liabilities | | | |
| Derivative liabilities | $ 3,458 | $ 9,009 | (61.6%) |
| Income taxes payable | 17,628 | – | – |
| Other liabilities | 136,025 | 140,554 | (3.2%) |
| Deferred tax liabilities | 40,040 | 40,113 | (0.2%) |
| | $ 197,151 | $ 189,676 | 3.9% |

The growth in other assets was driven by the growth in derivative assets and intangible assets. Derivative assets and liabilities are discussed in the Derivatives and Hedging section of this MD&A. The growth in intangible assets reflects the software development costs related to the Company's new core banking system. Development of this new core banking system was substantially completed during the fourth quarter of 2011, at which time capitalization ceased and amortization of these costs commenced. Further information on the Company's intangible assets can be found in Note 9 to the consolidated financial statements included in this report.

Goodwill is subject to an annual impairment test to determine whether the asset continues to maintain its value. The Company completed an annual impairment analysis and concluded that the goodwill was not impaired. Further details of this impairment analysis can be found in Note 10 to the consolidated financial statements included in this report.

Capital assets, accrued interest receivable and prepaid assets generally increase in proportion to the increase in total loans and general business growth.

The increase in other liabilities resulted primarily from the income taxes payable of $17.6 million at December 31, 2011. Income taxes were a receivable balance of $9.5 million at December 31, 2010. This change from a receivable to a payable followed receipt of prior year tax recoveries and increases in current taxes relative to installments that have been made as required.

### 2012 Outlook for Other Assets and Liabilities

Other assets and liabilities are expected to grow in line with growth in total loans and general business growth. Growth in intangible assets will continue in 2012 as new software development activities are underway. However, this growth will be significantly less than in 2011 and in previous years as a result of the completion of the Company's new core banking system.

### Shareholders' Equity

**Table 18: Shareholders' Equity**

| (000s, except %) | 2011 | 2010 | Change |
|---|---|---|---|
| Shareholders' equity at the beginning of the year | $ 628,585 | $ 503,623 | 24.8% |
| Net income | 190,080 | 154,752 | 22.8% |
| Other comprehensive income | (15,097) | (4,299) | 251.2% |
| Amounts related to stock-based compensation | 6,223 | 6,274 | (0.8%) |
| Repurchase of shares | (7,946) | (8,524) | (6.8%) |
| Dividends | (27,060) | (23,241) | 16.4% |
| Shareholders' equity at the end of the year | $ 774,785 | $ 628,585 | 23.3% |

The increase in total shareholders' equity was internally generated from net income during the year. Also contributing to the increase were amounts related to stock-based compensation. These increases were partially offset by the decrease in accumulated other comprehensive income, amounts related to the repurchase of the Company's common shares and dividends. Details related to stock-based compensation and the repurchase of shares are provided in Note 14 to the consolidated financial statements included in this report.

At December 31, 2011, the book value per common share was $22.38, compared to $18.14 at December 31, 2010.

Strong earnings contributed to continuing robust returns on shareholders' equity. Return on equity when combined with the $0.76 per common share dividend in fiscal 2011 ($0.66 per common share in 2010) confirms the Company's continued commitment to total shareholder return.

### Contingencies and Contractual Obligations

During the year the Company became aware of alleged irregularities regarding three of its loans with a total principal amount of $4.6 million. These loans were advanced to the same borrower, a Toronto residential condominium corporation. The registered security documents associated with these loans provide the Company with a secured priority claim against the condominium corporation, the condominium structure and the underlying residential units. Provided that the security is valid, the Company would expect to recover any losses on such loans. The borrower is disputing the validity of the Company's security in the Ontario Court. It is not currently possible to reasonably determine the outcome of this matter or to estimate the amount of loss, if any. A specific provision has not been recorded for these loans but these loans have been classified as non-performing residential loans.

In the normal course of its activities, the Company enters into various types of contractual agreements. The main obligations result from the acceptance of deposits from retail investors to finance its lending activities. The Company ensures that sufficient cash resources are available to meet these contractual obligations when they become due.

In addition to the obligations related to deposits, securitization liabilities, and senior debt previously discussed, the following table presents a summary of the Company's other contractual obligations as at December 31, 2011.

**Table 19: Contractual Obligations**

| (000s) | 2012 | 2013 | 2014 | 2015 | 2016 | Thereafter | **Total** |
|---|---|---|---|---|---|---|---|
| Premises and equipment | $ 3,283 | $ 2,997 | $ 2,672 | $ 2,482 | $ 2,507 | $ 16,305 | **$ 30,246** |

The Company also has outstanding commitments for future advances on mortgages and unutilized and available credit on its credit card products. Refer to the Off-Balance Sheet Arrangements section of this report and Note 18 to the consolidated financial statements for a description of those commitments.

### Derivatives and Hedging

From time to time, the Company enters into derivative transactions primarily in order to hedge interest rate exposure resulting from outstanding loan commitments and requirements to replace assets in the CMB program, as well as interest rate risk on fixed-rate debt. The Company uses Government of Canada bond forwards and interest rate swaps to hedge the impact of movements in interest rates between the time that mortgage commitments are made and the time that those mortgages are funded and/or securitized. Hedges are structured such that the fair value movements of the hedge instruments offset, within a reasonable range, the changes in the fair value of the pool of fixed rate mortgages due to interest rate fluctuations between commitment and funding. The term of these hedges is generally 60 to 150 days. These hedge instruments are settled or unwound at the time of funding or securitization of the underlying mortgages. Beginning in December 2010, the Company started applying cash flow hedge accounting to the Government of Canada bond forwards and certain interest rate swaps. The intent of hedge accounting is to recognize the effective matching of the gain or loss on the Government of Canada bond forwards and interest rate swaps with the recognition of the related interest expense.

For the year ended December 31, 2011, the Company settled $375.0 million and $25.0 million in Government of Canada bond forwards and interest rate swaps, recording net losses of $6.9 million and $0.4 million, respectively, in other comprehensive income. These losses reflect a decline in bond yields over the period of the hedge and have been deferred through accumulated other comprehensive income. These losses will be recognized in income over the term of the related funding source, which is a CMB liability, as part of the interest expense of the CMB liability. During the year ended December 31, 2011, the Company transferred $0.6 million to interest expense from accumulated other comprehensive income related to cash flow hedges on the secured borrowing. The Company also recognized $0.6 million for the year ended December 31, 2011 in losses into income through net realized and unrealized gain (loss) on derivatives in respect of these derivatives, due to hedge ineffectiveness. At December 31, 2011, the Company did not hold any derivatives under this hedging program. Prior to December 2010, the Company recognized unrealized and realized gains and losses on the Government of Canada bond forwards through income as they occurred, as hedge accounting was not in place.

The Company is exposed to interest rate risk through participation in the CMB program due to reinvestment risk between the amortizing fixed rate MBS and the bullet fixed rate CMB. To hedge this risk, the Company enters into interest rate swaps. Beginning in January 2011, the Company started applying fair value hedge accounting to the majority of these hedges. The intent of hedge accounting is to have the fair value changes in the interest rate swap offset, within a reasonable range, the changes in the fair value of the fixed rate borrowing resulting from changes in the interest rate environment. Any unmatched fair value change is recorded in income as hedge ineffectiveness through net realized and unrealized gain (loss) on derivatives. The total notional value of the interest rate swaps at December 31, 2011 was $1.64 billion. For the year ended December 31, 2011, unrealized gains of $53.5 million were recorded on the interest swaps and were offset by an unrealized gain on the hedged risk of the fixed rate liability of $53.3 million. Net hedge ineffectiveness gains of $0.2 million for the year ended December 31, 2011, were recorded in the income statement through net realized and unrealized gain (loss) on derivatives.

The Company also has certain interest rate swaps that are not designated or do not qualify for hedge accounting relationships and therefore are adjusted to fair value without an offsetting hedged amount. These swaps are economic hedges of interest rate risk. These swaps had notional amounts of $118.1 million at December 31, 2011. Unrealized losses of $3.6 million for the year ended December 31, 2011, were recorded in income through net realized and unrealized gain (loss) on derivatives.

Prior to January 2011, interest rate swaps were not designated in hedge accounting relationships and the fair value change was recorded in income without a recorded offsetting fair value change in the hedged risk. This resulted in income volatility in 2010 as measured using IFRS. In January 2011, the interest rate swaps were restructured to rebalance the interest rate hedges and to meet hedge accounting requirements. During the period between December 31, 2010 and the restructuring and hedge designation date, an unrealized loss on fair value changes of $3.7 million was recorded in income through net realized and unrealized gain (loss) on derivatives. For performance measurement purposes, this loss, net of tax, has been removed from the calculation of adjusted net income and adjusted earnings per share.

Please see Note 19 of the consolidated financial statements for further information.

### Off-Balance Sheet Arrangements

In the normal course of its business, the Company offers credit products to meet the financial needs of its customers. Outstanding commitments for future advances on mortgage loans amounted to $612.4 million at December 31, 2011 ($458.8 million – December 31, 2010). Included within the outstanding commitments are unutilized non-residential loan advances of $40.5 million at December 31, 2011 ($45.4 million – December 31, 2010). Commitments for the loans remain open for various dates. As at December 31, 2011, unutilized credit card balances amounted to $89.6 million ($76.5 million – December 31, 2010). Outstanding commitments for future advances for the Equityline *Visa* portfolio were $10.5 million at December 31, 2011 ($5.1 million – December 31, 2010).

## OPERATING SEGMENT REVIEW

The following section summarizes the operating segments of the Company. The Company operates principally through two segments, mortgage lending and consumer lending. These operating segments are supported by other activities, including treasury and general corporate activities. For more detailed information, refer to Note 23 to the consolidated financial statements in this report.

Mortgage lending remains the Company's key segment, contributing 81.7% (74.0% in 2010) to the Company's net income in 2011, while consumer lending contributed 15.8% (16.0% in 2010) and the Other segment contributed 2.5% (10.0% in 2010). The Other segment includes dividend income, which is tax exempt for the Company, and therefore tax provisions in this segment are correspondingly reduced or reflect a recovery.

### Mortgage Lending

**Table 20: Mortgage Lending**

| (000s, except %) | 2011 | 2010 | Change |
|---|---|---|---|
| Net interest income | $ 273,738 | $ 202,745 | 35.0% |
| Provision for credit losses | (5,916) | (5,304) | 11.5% |
| Fees and other income | 19,457 | 15,243 | 27.6% |
| Net (loss) gain on securities and others | (4,821) | 10,608 | (145.4%) |
| Non-interest expenses | (67,851) | (61,114) | 11.0% |
| Income before income taxes | 214,607 | 162,178 | 32.3% |
| Income taxes | (59,331) | (47,676) | 24.4% |
| Net income | $ 155,276 | $ 114,502 | 35.6% |
| Goodwill | $ 2,324 | $ 2,324 | – |
| Total assets | $ 15,997,106 | $ 13,797,202 | 15.9% |
| **Additional financial information** | | | |
| Total segment revenue | $ 696,001 | $ 588,301 | |
| as a percentage of total revenue | 88.0% | 85.6% | |
| Net segment income | $ 155,276 | $ 114,502 | |
| as a percentage of total net income | 81.7% | 74.0% | |
| Efficiency ratio (TEB) | 23.5% | 26.7% | |
| Net interest margin (TEB) | 1.8% | 1.7% | |

The principal line of business, the mortgage lending segment, continued its strong performance, contributing $155.3 million in net income for the year, compared to $114.5 million for 2010. Net interest income continues to grow on higher loan balances and net interest margin, reflecting continued strong demand for the Company's products through enhanced broker relationships, superior customer service and stable real estate markets across most of the country. The Company's strategic shift in focus to higher-yielding traditional products has resulted in an improvement in net interest margin.

The increase in net interest income for 2011 over 2010 reflects higher average mortgage loan balances and higher net interest margin. Average loan balances were $3.60 billion higher for the twelve months ending December 31, 2011 compared to 2010.

The efficiency ratio is improved over 2010 on higher expenses, reflecting improving efficiency. The increase in expenses relates to higher costs associated with growth in mortgage loans under administration and additional costs associated with the implementation of the Company's new core banking system. There were accompanying increases in income tax associated with higher income. Provisions for credit losses for the mortgage lending segment remain within expected and acceptable ranges. Please see the Provision and Allowance for Credit Losses section of this MD&A for further discussion.

The Company's focus on customer service and broker relationships, as well as the breadth of mortgage product offerings, is leading to expanded market penetration. The Company began offering Equityline *Visa* products along with mortgages as a packaged product to qualified customers in 2010. Through this and other initiatives, the Company has been able to offer a "one-stop" and "flexible lending solution" to brokers and customers, driving both increased traditional mortgage originations and new Equityline *Visa* accounts, which are included in the consumer lending line of business.

### 2012 Outlook for Mortgage Lending

The Company's mortgage segment will continue to be the major contributor to the earnings of the Company in 2012, with additional growth in the Company's profitable uninsured loan products.

### Consumer Lending

**Table 21: Consumer Lending**

| (000s, except %) | 2011 | 2010 | Change |
|---|---|---|---|
| Net interest income | **$ 41,782** | $ 35,761 | 16.8% |
| Provision for credit losses | **(1,603)** | (4,127) | (61.2%) |
| Fees and other income | **18,051** | 15,229 | 18.5% |
| Gain on sale of loan portfolio | **–** | 3,917 | (100.0%) |
| Non-interest expenses | **(16,255)** | (14,945) | 8.8% |
| Income before income taxes | **41,975** | 35,835 | 17.1% |
| Income taxes | **(11,872)** | (11,129) | 6.7% |
| Net income | **$ 30,103** | $ 24,706 | 21.8% |
| Goodwill | **$ 13,428** | $ 13,428 | – |
| Total assets | **$ 614,626** | $ 514,872 | 19.4% |
| **Additional financial information** | | | |
| Total segment revenue | **$ 67,987** | $ 61,681 | |
| as a percentage of total revenue | **8.6%** | 9.0% | |
| Net segment income | **$ 30,103** | $ 24,706 | |
| as a percentage of total net income | **15.8%** | 16.0% | |
| Efficiency ratio (TEB) | **27.2%** | 27.2% | |
| Net interest margin (TEB) | **7.4%** | 8.0% | |

Consumer lending, which includes *Visa*, retail lending and payment card services, continues to generate positive returns for the Company. Net interest income for 2011 increased by 16.8% compared to 2010, primarily due to an increase in outstanding receivables. The decrease in net interest margin is primarily attributed to a reduction in the yield on the Equityline *Visa* portfolio as the Company began to issue lower rate cards to high-quality borrowers and the introduction of water heater loans in 2010, which have lower average rates. There was also an increase in the allocated cost of funds.

Fees and other income increased over 2010 on a higher number of accounts in 2011.

Expenses have increased to support the business growth and the Company continues to effectively manage its expenditures, reflected in a consistent efficiency ratio year over year, while at the same time increasing the size of both its *Visa* and retail lending portfolios and investing in infrastructure to support future growth initiatives.

In 2011, 7,697 Equityline *Visa* accounts with $203.7 million in authorized credit limits were issued, compared to 6,263 accounts with $186.6 million in authorized credit limits issued in 2010. The Equityline *Visa* accounts are fully secured by residential real estate. EquityLine *Visa* represents 97.8% of the *Visa* portfolio.

The largest component of retail lending, representing 88.1% of the portfolio, is water heater loans. There were 46,223 new water heater accounts added during 2011. Water heater receivables increased by $57.1 million during the year to $173.2 million.

Included in the operating results of the consumer lending segment are the operations of PSiGate. The Company expects PSiGate to continue to contribute revenue growth for the consumer lending segment. For 2011, PSiGate contributed $1.9 million to the net income of the consumer lending segment, compared to $1.5 million in 2010.

### 2012 Outlook for Consumer Lending

The consumer lending portfolio will contribute favourably to the Company's profitability in 2012. The Company anticipates continued measured growth in the water heater line of business and is currently exploring this channel for other growth opportunities. Equityline *Visa* is anticipated to continue to generate returns consistent with 2011, while the rate of growth in outstanding receivables may moderate compared to 2011.

## Other

**Table 22: Other**

| (000s, except %) | 2011 | 2010 | Change |
|---|---|---|---|
| Net interest income | **$ 18,432** | $ 25,524 | (27.8%) |
| Fees and other income | **489** | 218 | 124.3% |
| Net gain on securities and others | **1,706** | 8,953 | (80.9%) |
| Non-interest expenses | **(20,896)** | (19,417) | 7.6% |
| Income before income taxes | **(269)** | 15,278 | (101.8%) |
| Income tax recoveries | **4,970** | 266 | 1,768.4% |
| Net income | **$ 4,701** | $ 15,544 | (69.8%) |
| Total assets | **$ 1,084,739** | $ 1,206,744 | (10.1%) |
| **Additional financial information** | | | |
| Total segment revenue | **$ 26,603** | $ 37,267 | |
| as a percentage of total revenue | **3.4%** | 5.4% | |
| Net interest margin (TEB) | **2.2%** | 2.5% | |

The Other segment includes the operating results from the Company's securities portfolio and corporate activities. Net income for the year was $4.7 million compared to a net income of $15.5 million in 2010. The decrease in income for the segment is due to lower net interest income and lower net gain on securities and others. Net interest income is down due to higher interest expenses related to CMB repurchase agreement (repo) costs and interest expenses on senior debt issued in 2011. Further, the gain on sale of securities and others is also down due to $3.4 million in unrealized losses for fair value changes in interest rate swaps that are not designated in hedge accounting relationships, and impairment of securities of $3.0 million. The Company realized a net gain of $7.1 million on the sale of certain available for sales securities in 2011, compared to a gain of $10.1 million in 2010.

The tax amounts allocated to this segment reflect the benefit of non-taxable dividends from Canadian companies.

### 2012 Outlook for Other

The Other segment primarily generates its income from the Company's securities portfolio. Income from this source is highly correlated with the movement in interest rates and performance of the Canadian capital markets.

## SUMMARY OF QUARTERLY RESULTS

**Table 23: Summary of Quarterly Results**

| (000s, except per share and %) | 2011 | | | | 2010 | | | |
|---|---|---|---|---|---|---|---|---|
| | **Q4** | **Q3** | **Q2** | **Q1** | Q4 | Q3 | Q2 | Q1 |
| Net interest income (TEB)[1] | **$ 90,197** | **$ 89,478** | **$ 83,121** | **$ 78,232** | $ 74,238 | $ 70,104 | $ 64,234 | $ 63,354 |
| Less: TEB adjustment | **1,785** | **1,866** | **1,799** | **1,626** | 1,779 | 1,993 | 2,032 | 2,096 |
| Net interest income per financial statements | **88,412** | **87,612** | **81,322** | **76,606** | 72,459 | 68,111 | 62,202 | 61,258 |
| Non-interest income | **9,658** | **5,661** | **12,454** | **7,109** | 1,891 | 24,004 | 20,221 | 8,052 |
| Non-interest expense | **27,107** | **26,036** | **26,643** | **25,216** | 26,610 | 24,756 | 24,357 | 19,753 |
| Total revenues | **207,122** | **200,288** | **198,568** | **184,613** | 176,044 | 187,195 | 170,407 | 153,603 |
| Net income | **50,280** | **48,417** | **48,206** | **43,178** | 30,108 | 47,621 | 41,316 | 35,707 |
| Adjusted return on common shareholders' equity | **26.7%** | **27.0%** | **28.2%** | **28.2%** | 22.2% | 27.0% | 26.4% | 29.7% |
| Return on average total assets | **1.2%** | **1.2%** | **1.2%** | **1.1%** | 0.8% | 1.4% | 1.3% | 1.2% |
| Earnings per common share | | | | | | | | |
| Basic | **$ 1.45** | **$ 1.40** | **$ 1.39** | **$ 1.24** | $ 0.87 | $ 1.37 | $ 1.19 | $ 1.03 |
| Diluted | **$ 1.45** | **$ 1.39** | **$ 1.38** | **$ 1.24** | $ 0.87 | $ 1.37 | $ 1.19 | $ 1.03 |
| Book value per common share | **$ 22.38** | **$ 21.10** | **$ 20.24** | **$ 19.14** | $ 18.14 | $ 17.44 | $ 16.06 | $ 15.26 |
| Efficiency ratio (TEB)[1] | **27.1%** | **27.4%** | **27.9%** | **29.6%** | 35.0% | 24.6% | 28.8% | 27.7% |
| Efficiency ratio | **27.6%** | **27.9%** | **28.4%** | **30.1%** | 35.8% | 25.1% | 29.6% | 28.5% |
| Tier 1 capital ratio[2] | **17.3%** | **17.7%** | **18.4%** | **19.0%** | 18.1% | 16.9% | 16.7% | 16.5% |
| Total capital ratio[2] | **20.5%** | **21.0%** | **22.1%** | **20.3%** | 19.4% | 18.1% | 17.9% | 17.9% |
| Non-performing loans as a % of gross loans | **0.25%** | **0.32%** | **0.23%** | **0.29%** | 0.24% | 0.26% | 0.34% | 0.47% |
| Annualized provision as a % of gross loans | **0.07%** | **0.06%** | **0.03%** | **0.03%** | 0.17% | 0.07% | 0.02% | 0.04% |

[1] TEB – Taxable Equivalent Basis, see definition under Non-GAAP Measures.

[2] These figures relate to the Company's operating subsidiary, Home Trust Company.

The Company's key financial measures for each of the last eight quarters are summarized in the previous table. These highlights illustrate the Company's profitability and return on equity, as well as efficiency measures and capital ratios. The quarterly results are modestly affected by seasonal factors, with first quarter mortgage advances typically impacted by winter weather conditions, first quarter arrears impacted by the holiday season and the fourth quarter normally producing increased credit card activity over the holiday period.

The Company continues to achieve positive financial results driven by revenue growth in mortgage lending, and continued low efficiency ratios. Tier 1 and Total capital ratios through 2010 and into 2011 reflect the Company's prudent capital management strategies and the proactive approach to maintaining a strong capital base.

Return on equity or adjusted return on equity has remained above 22% for the last eight quarters.

## FOURTH QUARTER 2011 PERFORMANCE

The Company continued its strong performance in the fourth quarter of 2011. Key results for the fourth quarter of 2011 are as follows:

> Net income of $50.3 million was 47.1% higher than the $34.2 million adjusted net income recorded in the fourth quarter of 2010. Fourth quarter of 2011 net income increased 3.8% over third quarter of 2011 net income.

> Core earnings of $96.7 million (net interest income after provision plus fee and other income) were up by 28.4% over the fourth quarter of 2010 core earnings of $75.3 million and up 1.8% over the third quarter core earnings of $95.0 million.

> Basic and diluted earnings per share were $1.45 for the fourth quarter. This represents an increase of 46.5% and 48.0%, respectively, from $0.99 and $0.98 adjusted basic and diluted earnings per share in the fourth quarter of 2010 and an increase of 3.6% and 4.3% over the $1.40 and $1.39 recorded in the third quarter of 2011.

> Adjusted return on equity was 26.7% in the quarter compared to 22.2% in the comparable quarter of 2010 and 27.0% in the third quarter of 2011.

> Net interest margin was 2.06% in the fourth quarter compared to 1.99% in the comparable quarter of 2010 and 2.14% in the third quarter of 2011. Total net interest margin is influenced by the mix of the loan portfolio between securitized and non-securitized mortgages and by the net interest margin on each of these portfolios. In the fourth quarter of 2010 the loans portfolio was more heavily weighted towards securitized and Accelerator mortgages, which have lower margins resulting in a lower overall net interest margin. The net interest margin on securitized loans declined in the fourth quarter of 2011 compared to the third quarter due to the maturity of higher-yielding maturing NHA MBS assets and lower yielding CMB replacement assets. This resulted in a lower net interest margin in the fourth quarter when compared to the third quarter of 2011.

> The credit quality and performance of the loans portfolio remained solid in the fourth quarter. Net non-performing loans ended 2011 at 0.25% of the total loans portfolio compared to 0.24% at the end of 2010 and 0.32% at the end of the third quarter of 2011. The provision for credit losses for the fourth quarter was 0.07% of gross loans on an annualized basis and 0.05% for the year compared to 0.17% in the comparable quarter of 2010 and 0.07% for the 2010 year and 0.06% in the third quarter of 2011.

> Total assets grew to $17.70 billion at the end of 2011, an increase of $2.18 billion or 14.0% over the $15.52 billion recorded at the end of 2010 and $624.3 million or 3.7% over the $17.07 billion recorded at the end of the third quarter of 2011. Total loans increased by $2.00 billion in 2011 to $16.09 billion, representing growth of 14.2% over the $14.09 billion at the end of 2010. During the fourth quarter of 2011, total loans increased by $307.0 million or 1.9% from $15.78 billion at the end of the third quarter of 2011.

> The total value of mortgages originated in the fourth quarter of 2011 was $1.25 billion compared to $1.85 billion in the fourth quarter of 2010 and $1.30 billion in the third quarter of 2011. The year-over-year decline in originations reflects the Company's strategy to shift origination focus from Accelerator (insured) mortgage products, which are generally securitized, to originations of higher yielding traditional mortgages.

> The Company originated $948.8 million of traditional mortgages in the fourth quarter compared to $683.5 million in the same quarter of 2010 and $941.1 million in the third quarter of 2011.

> Accelerator (insured) mortgage originations were $188.5 million in the fourth quarter of 2011 compared to $755.6 million in the comparable quarter of 2010 and $293.5 million in the third quarter of 2011.

> Multi-unit residential originations were $6.5 million for the fourth quarter of 2011 compared to $285.0 million in the same quarter of 2010 and $7.0 million in the third quarter of 2011. A significant portion of multi-unit residential mortgages originated in 2010 was insured and securitized and the reduction in origination volume is a result of narrowing margins and the cost of increased capital required to support this product.

> Non-residential mortgage advances were $41.5 million in the quarter compared to $72.9 million in the comparable quarter of 2010 and $32.4 million in the third quarter of 2011. The Company maintains a cautious approach to increases in this portfolio.

> Store and apartment advances were $35.5 million for the quarter compared to $33.6 million in the same period of 2010 and $26.8 million in the third quarter of 2011.

> As a source of funding and replacement assets for the CMB program, the Company securitized and sold $272.9 million in insured residential mortgages in the fourth quarter compared to $1.86 billion in the fourth quarter of 2010 and $396.8 million in the third quarter of 2011.

> Deposits and securitization liabilities increased to $16.57 billion at the end of 2011, an increase of 12.7% from the $14.70 billion at the end of 2010 and an increase of 3.8% from the $15.97 billion at the end of the third quarter of 2011. Deposits and securitization liabilities generally grow in proportion to growth in the loans portfolio and changes in the level of liquidity.

> Fees and other income were $11.3 million in the fourth quarter and represent an increase of 31.0% over the $8.6 million earned in the fourth quarter of 2010 and an increase of 16.5% from the $9.7 million earned in the third quarter of 2011. Fees and other income increase as the number of loans grow. Fees and other income have grown at a faster pace than the loan portfolio reflecting the relative shift in the portfolio to traditional loans that tend to earn higher fees.

> Securities and derivative gains and losses resulted in a net loss of $1.6 million in the fourth quarter compared to a net loss of $6.7 million in the comparable quarter of 2010 and a net loss of $4.0 million in the third quarter of 2011. The Company recognized $1.1 million in unrealized losses through income on the impairment of certain available for sale securities in the fourth quarter compared to $0.4 million in the comparable quarter of 2010 and $0.8 million in the third quarter of 2011. The Company realized losses of $0.2 million on the sale of available for sale securities in the quarter compared to $0.5 million in losses recorded in the comparable quarter of 2010 and $2.0 million in gains in the third quarter of 2011. Derivatives gains and losses include amounts associated with the application of hedge accounting in 2011 and amounts associated with derivatives not in hedge accounting relationships in 2011 and 2010 (please see the Derivatives and Hedging section of the MD&A and Note 19 to the consolidated financial statements for more information). In the fourth quarter the Company recorded $0.3 million in derivatives losses compared to $5.7 million in the comparable quarter of 2010 and $5.3 million in the third quarter of 2011. Certain derivative gains and losses that are reflective of accounting mismatches are adjusted from net income in 2010 and 2011 for performance measurement purposes.

> The efficiency ratio (TEB) was 27.1% in the fourth quarter, compared to 35.0% in the comparable quarter of 2010 and 27.4% in the third quarter of 2011. The Company continues to manage expenses effectively and in line with revenue growth. The fourth quarter of 2010 efficiency ratio was elevated by unmatched derivative gains and losses.

## Fourth Quarter Segment Review

### *Mortgage Lending*

The mortgage lending segment continued its strong performance in the fourth quarter, with net income of $42.7 million, up 43.3% over the $29.8 million in adjusted net income earned in the comparable quarter of 2010 and up 1.4% from the $42.1 million earned in the third quarter of 2011. Net interest income continues to grow on higher loan balances and strong net interest margins, reflecting continued strong demand for the Company's products through enhanced broker relationships, superior customer service and stable real estate markets in most regions across much of the country.

### *Consumer Lending*

Consumer lending continues to generate attractive returns for the Company. Net income for the fourth quarter of 2011 of $7.6 million doubled from the $3.8 million earned in the same quarter of 2010 due to higher outstanding loans and lower credit provisions. Fourth quarter 2011 net income was flat compared to third quarter net income of $7.6 million. In the fourth quarter, credit provisions increased due to management's decision to write off $2.0 million related to the 2010 fraud in the *Visa* portfolio.

The average net interest margin earned on the *Visa* portfolio was 8.2% during the fourth quarter, compared to 8.4% in the same quarter of 2010 and 8.4% in the third quarter of 2011. The average net interest margin earned in the consumer lending portfolio was 7.3% during the quarter, compared to 7.4% in the comparable quarter of 2010 and 7.9% in the third quarter of 2011. The decrease in interest margin from last year is primarily due to the higher allocated cost of funds.

During the quarter, 1,814 Equityline *Visa* accounts with $44.2 million in authorized credit limits were issued, compared to 1,864 accounts with $54.2 million in authorized credit limits issued in the comparable quarter of 2010 and 1,758 accounts with $47.3 million in authorized credit limits in the third quarter of 2011.

The Company's consumer lending portfolio also includes the results from its retail lending operations. The largest component of retail lending, representing 88.1% of the portfolio, is water heater loans. There were 10,061 new water heater accounts added during the quarter, a decrease of 21.1% over the 13,434 added in the third quarter of 2011. Total retail lending receivables increased by $14.5 million during the quarter, to reach $173.2 million at the end of 2011.

Consumer lending also includes the results of PSiGate which contributed $0.5 million to net income for the quarter, compared to $0.4 million in the comparable quarter of 2010 and $0.4 million in the third quarter of 2011.

### *Other*

The other segment includes the operating results from the Company's treasury portfolio and corporate activities. Net interest income declined from the prior year, reflecting lower yields on liquidity assets and lower average balances of liquid assets as the Company reduced its securitization activity in 2011. Securitization activity generally requires higher balances of liquid assets to support the accumulation of assets and subsequent exchange of cash.

## FOURTH QUARTER FINANCIAL INFORMATION

### Table 24: Fourth Quarter Net Interest Income and Margin

| | For the three months ended | | | |
|---|---|---|---|---|
| | **December 31, 2011** | | December 31, 2010 | |
| (000s, except %) | **Income/ Expense** | **Average Rate[1]** | Income/ Expense | Average Rate[1] |
| **Assets** | | | | |
| Cash and cash resources | **$ 986** | **0.67%** | $ 1,944 | 1.11% |
| Securities | **4,664** | **4.69%** | 5,430 | 3.09% |
| Non-securitized loans | **109,938** | **5.81%** | 90,195 | 5.84% |
| Taxable equivalent adjustment | **1,785** | **–** | 1,779 | – |
| Total on non-securitized interest earning assets | **117,373** | **5.48%** | 99,348 | 5.42% |
| Securitized loans | **81,876** | **3.76%** | 76,584 | 4.22% |
| **Total assets** | **$ 199,249** | **4.55%** | $ 175,932 | 4.72% |
| **Liabilities and shareholders' equity** | | | | |
| Deposits | **$ 50,371** | **2.63%** | $ 47,988 | 2.90% |
| Securitization liabilities | **56,667** | **2.60%** | 53,706 | 2.96% |
| Other liabilities and shareholders' equity | **2,014** | **5.25%** | – | – |
| **Total liabilities and shareholders' equity** | **$ 109,052** | **2.49%** | $ 101,694 | 2.73% |
| **Net interest income (TEB)** | **$ 90,197** | | $ 74,238 | |
| **Tax equivalent adjustment** | **(1,785)** | | (1,779) | |
| **Net interest income per financial statements** | **$ 88,412** | | $ 72,459 | |
| **Net interest margin non-securitized interest earning assets[2]** | | **3.03%** | | 2.80% |
| **Net interest margin securitized assets** | | **1.16%** | | 1.26% |
| **Total net interest margin[2]** | | **2.06%** | | 1.99% |
| **Spread of non-securitized loans over deposits only** | | **3.18%** | | 2.94% |

1 The average rate is an average calculated with reference to opening and closing monthly balances.

2 Net interest margin is calculated on a TEB.

**Table 25: Fourth Quarter Interest Income and Average Rate by Loan Portfolio**

For the three months ended

| (000s, except %) | **December 31, 2011** Average Assets[1] | Interest Income | Average Rate[1] | December 31, 2010 Average Assets[1] | Interest Income | Average Rate[1] |
|---|---|---|---|---|---|---|
| Traditional single-family residential mortgages | **$ 5,762,047** | **$ 79,086** | **5.49%** | $ 3,833,536 | $ 59,087 | 6.17% |
| Accelerator single-family residential mortgages | **187,200** | **1,196** | **2.56%** | 768,201 | 3,888 | 2.02% |
| Multi-unit residential mortgages | **112,288** | **1,544** | **5.50%** | 316,967 | 3,482 | 4.39% |
| Securitized residential mortgages | **8,703,077** | **81,876** | **3.76%** | 7,255,749 | 76,584 | 4.22% |
| Non-residential mortgages | **957,859** | **14,844** | **6.20%** | 812,681 | 12,756 | 6.28% |
| Personal and credit card loans | **555,359** | **13,268** | **9.56%** | 443,238 | 10,982 | 9.91% |
| **Total average loans** | **$ 16,277,830** | **$ 191,814** | **4.71%** | $ 13,430,372 | $ 166,779 | 4.97% |

[1] The average is an average calculated with reference to opening and closing monthly balances.

**Table 26: Fourth Quarter Mortgage Production**

For the three months ended

| (000s) | **December 31 2011** | December 31 2010 |
|---|---|---|
| Traditional single-family residential mortgages | **$ 948,848** | $ 683,511 |
| Accelerator single-family residential mortgages | **188,484** | 755,632 |
| Multi-unit residential mortgages | **6,522** | 285,042 |
| Non-residential mortgages | **41,508** | 72,855 |
| Store and apartments | **35,544** | 33,623 |
| Warehouse commercial mortgages | **27,000** | 20,750 |
| **Total mortgage advances** | **$ 1,247,906** | $ 1,851,413 |

**Table 27: Fourth Quarter Review of Financial Performance**

| For the three months ended December 31 (000s, except per share amounts) | 2011 | 2010 | Change |
|---|---|---|---|
| **Net interest income non-securitized assets** | | | |
| Interest from loans | $ 109,938 | $ 90,195 | 21.9% |
| Dividends from securities | 4,559 | 4,098 | 11.2% |
| Other interest | 1,091 | 3,276 | (66.7%) |
| | 115,588 | 97,569 | 18.5% |
| Interest on deposits | 50,371 | 47,988 | 5.0% |
| Interest on senior debt | 2,014 | – | – |
| Net interest income non-securitized assets | 63,203 | 49,581 | 27.5% |
| **Net interest income securitized loans and assets** | | | |
| Interest income from securitized loans and assets | 81,876 | 76,584 | 6.9% |
| Interest expense on securitization liabilities | 56,667 | 53,706 | 5.5% |
| Net interest income securitized loans and assets | 25,209 | 22,878 | 10.2% |
| **Total net interest income** | 88,412 | 72,459 | 22.0% |
| Provision for credit losses | 2,979 | 5,816 | (48.8%) |
| | 85,433 | 66,643 | 28.2% |
| **Non-interest income** | | | |
| Fees and other income | 11,294 | 8,621 | 31.0% |
| Realized net gains and unrealized losses on securities | (1,306) | (985) | 32.6% |
| Net realized and unrealized loss on derivatives | (330) | (5,745) | (94.3%) |
| | 9,658 | 1,891 | 410.7% |
| | 95,091 | 68,534 | 38.8% |
| **Non-interest expenses** | | | |
| Salaries and benefits | 13,184 | 12,405 | 6.3% |
| Premises | 2,007 | 1,820 | 10.3% |
| Other operating expenses | 11,916 | 12,384 | (3.8%) |
| | 27,107 | 26,609 | 1.9% |
| **Income before income taxes** | 67,984 | 41,925 | 62.2% |
| Income taxes | | | |
| Current | 15,909 | 9,947 | 59.9% |
| Deferred | 1,795 | 1,869 | (4.0%) |
| | 17,704 | 11,816 | 49.8% |
| **NET INCOME** | $ 50,280 | $ 30,109 | 67.0% |
| Adjustment for unmatched derivative positions, net of tax[1] | $ – | $ 4,124 | (100.0%) |
| **ADJUSTED NET INCOME[1]** | $ 50,280 | $ 34,233 | 46.9% |
| **NET INCOME PER COMMON SHARE** | | | |
| Basic | $ 1.45 | $ 0.87 | 66.7% |
| Diluted | $ 1.45 | $ 0.87 | 66.7% |
| **ADJUSTED NET INCOME PER COMMON SHARE** | | | |
| Basic | $ 1.45 | $ 0.99 | 46.5% |
| Diluted | $ 1.45 | $ 0.98 | 48.0% |
| **AVERAGE NUMBER OF COMMON SHARES OUTSTANDING** | | | |
| Basic | 34,668 | 34,685 | (0.0%) |
| Diluted | 34,782 | 34,778 | 0.0% |
| Total number of outstanding common shares | 34,625 | 34,646 | (0.1%) |
| Book value per common share | $ 22.38 | $ 18.14 | 23.4% |

[1] See definition of Adjusted Net Income under Non-GAAP Measures.

**Table 28: Fourth Quarter Review of Comprehensive Income**

| For the three months ended December 31 (000s, except per share amounts) | 2011 | 2010 | Change |
|---|---|---|---|
| **NET INCOME** | **$ 50,280** | $ 30,109 | 67.0% |
| **OTHER COMPREHENSIVE LOSS** | | | |
| **Available for sale securities** | | | |
| Net unrealized gains on securities available for sale | **700** | 744 | (5.9%) |
| Net losses reclassified to net income | **1,174** | 759 | 54.7% |
| | **1,874** | 1,503 | 24.7% |
| Income tax expense (recovery) | **505** | (327) | (254.4%) |
| | **1,369** | 1,830 | (25.2%) |
| **Cash flow hedges** | | | |
| Net unrealized losses on cash flow hedges | **(639)** | – | – |
| Net losses reclassified to net income | **338** | – | – |
| | **(301)** | – | – |
| Income tax recovery | **(36)** | – | – |
| | **(265)** | – | – |
| Total other comprehensive income | **1,104** | 1,830 | (39.7%) |
| **COMPREHENSIVE INCOME** | **$ 51,384** | $ 31,939 | 60.9% |

**Table 29: Fourth Quarter Review of Financial Position**

| As at (000s) | December 31 2011 | September 30 2011 | Change |
|---|---|---|---|
| **ASSETS** | | | |
| **Cash resources** | **$ 665,806** | $ 417,701 | 59.4% |
| **Securities** | | | |
| Available for sale | **391,754** | 440,458 | (11.1%) |
| Pledged securities | **341,588** | 208,183 | 64.1% |
| | **733,342** | 648,641 | 13.1% |
| **Loans** | | | |
| Residential mortgages | **6,339,883** | 5,782,855 | 9.6% |
| Securitized residential mortgages | **8,243,350** | 8,502,466 | (3.0%) |
| Non-residential mortgages | **946,222** | 951,203 | (0.5%) |
| Personal and credit card loans | **560,193** | 546,122 | 2.6% |
| | **16,089,648** | 15,782,646 | 1.9% |
| Collective allowance for credit losses | **(29,440)** | (29,390) | 0.2% |
| | **16,060,208** | 15,753,256 | 1.9% |
| **Other** | | | |
| Derivative assets | **72,424** | 71,656 | 1.1% |
| Other assets | **79,650** | 99,581 | (20.0%) |
| Capital assets | **5,372** | 4,487 | 19.7% |
| Intangible assets | **63,917** | 61,051 | 4.7% |
| Goodwill | **15,752** | 15,752 | – |
| | **237,115** | 252,527 | (6.1%) |
| | **$ 17,696,471** | $ 17,072,125 | 3.7% |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | | |
| **Liabilities** | | | |
| **Deposits** | | | |
| Deposits payable on demand | **$ 62,746** | $ 27,000 | 132.4% |
| Deposits payable on a fixed date | **7,859,378** | 7,193,517 | 9.3% |
| | **7,922,124** | 7,220,517 | 9.7% |
| **Senior debt** | **153,336** | 153,998 | (0.4%) |
| **Securitization liabilities** | | | |
| Mortgage-backed security liabilities | **2,417,801** | 2,604,521 | (7.2%) |
| Canada Mortgage Bond liabilities | **6,231,274** | 6,148,605 | 1.3% |
| | **8,649,075** | 8,753,126 | (1.2%) |
| **Other** | | | |
| Derivative liabilities | **3,458** | 3,800 | (9.0%) |
| Income taxes payable | **17,628** | 10,413 | 69.3% |
| Other liabilities | **136,025** | 160,774 | (15.4%) |
| Deferred tax liabilities | **40,040** | 38,281 | 4.6% |
| | **197,151** | 213,268 | (7.6%) |
| | **16,921,686** | 16,340,909 | 3.6% |
| **Shareholders' equity** | | | |
| Capital stock | **55,104** | 54,489 | 1.1% |
| Contributed surplus | **5,873** | 5,453 | 7.7% |
| Retained earnings | **722,999** | 681,569 | 6.1% |
| Accumulated other comprehensive loss | **(9,191)** | (10,295) | (10.7%) |
| | **774,785** | 731,216 | 6.0% |
| | **$ 17,696,471** | $ 17,072,125 | 3.7% |

### Table 30: Earnings by Business Segment

For the three months ended December 31, 2011

| (000s) | Mortgage Lending | Consumer Lending | Other | Total |
|---|---|---|---|---|
| Net interest income | $ 74,164 | $ 10,639 | $ 3,609 | $ 88,412 |
| Provision for credit losses | (1,975) | (1,004) | – | (2,979) |
| Fees and other income | 6,829 | 4,343 | 122 | 11,294 |
| Net loss on securities and others | (1,095) | – | (541) | (1,636) |
| Non-interest expenses | (18,824) | (3,417) | (4,866) | (27,107) |
| Income before income taxes | 59,099 | 10,561 | (1,676) | 67,984 |
| Income taxes | (16,370) | (2,987) | 1,653 | (17,704) |
| Net income | $ 42,729 | $ 7,574 | $ (23) | $ 50,280 |
| Goodwill | $ 2,324 | $ 13,428 | $ – | $ 15,752 |
| Total assets | $ 15,997,106 | $ 614,626 | $ 1,084,739 | $ 17,696,471 |

For the three months ended December 31, 2010

| (000s) | Mortgage Lending | Consumer Lending | Other | Total |
|---|---|---|---|---|
| Net interest income | $ 57,053 | $ 8,990 | $ 6,416 | $ 72,459 |
| Provision for credit losses | (2,377) | (3,439) | – | (5,816) |
| Fees and other income | 4,624 | 3,928 | 69 | 8,621 |
| Net loss on securities and others | (5,697) | – | (1,033) | (6,730) |
| Non-interest expenses | (16,948) | (3,853) | (5,808) | (26,609) |
| Income before income taxes | 36,655 | 5,626 | (356) | 41,925 |
| Income taxes | (11,102) | (1,780) | 1,066 | (11,816) |
| Net income | $ 25,553 | $ 3,846 | $ 710 | $ 30,109 |
| Goodwill | $ 2,324 | $ 13,428 | $ – | $ 15,752 |
| Total assets | $ 13,797,202 | $ 514,872 | $ 1,206,744 | $ 15,518,818 |

## CAPITAL MANAGEMENT

Capital is a key factor in assessing the safety and soundness of a financial institution. A strong capital position assists the Company in promoting confidence among depositors, creditors, regulators and shareholders. The Company's Capital Management Policy governs the quantity and quality of capital held. The objective of the policy is to ensure that regulatory and risk-based capital requirements are met while also providing a sufficient return to investors. The Risk and Capital Committee and the Board of Directors review compliance with the policy on a quarterly basis.

### Capital Management Framework

Two capital standards are addressed in the Company's policy, the asset to capital multiple (ACM) and the risk-based capital ratios. Management reviews these ratios on an ongoing basis and the Board of Directors reviews both ratios quarterly.

Capital adequacy for Canadian banks and trust companies is governed by the requirements of the Office of the Superintendent of Financial Institutions Canada (OSFI). These requirements are consistent with the published framework to measure the adequacy of capital for international banks, issued by the Bank for International Settlements (BIS), referred to as the BIS ratio. Under these standards, there are two components of capital. Tier 1 consists primarily of shareholders' equity and non-cumulative preferred shares. Tier 2 consists primarily of subordinated debentures, cumulative preferred shares, and the collective allowance. As Home Trust, the wholly owned subsidiary of the Company, is regulated under the Trust and Loan Companies Act (Canada), its ability to accept deposits is limited by Home Trust's permitted ACM. This is defined as the ratio of regulatory capital to the total assets of Home Trust.

The table below shows both the ACM and the risk-based capital ratio.

**Table 31: Regulatory Capital (Based only on the subsidiary, Home Trust Company)**

| (000s, except % and multiples) | 2011 | 2010 (Canadian GAAP)[4] |
|---|---|---|
| Tier 1 capital | | |
| Capital stock | $ 23,497 | $ 23,497 |
| Contributed surplus | 951 | 951 |
| Retained earnings | 717,223 | 658,530 |
| Accumulated other comprehensive loss[1] | (4,229) | – |
| IFRS transition adjustment | 49,188 | – |
| Total | 786,630 | 682,978 |
| Tier 2 capital | | |
| Collective allowance for credit losses[2] | 29,440 | 29,153 |
| Accumulated other comprehensive income[3] | – | 4,545 |
| Subordinated debentures | 115,000 | 15,000 |
| Total | 144,440 | 48,698 |
| Total regulatory capital | $ 931,070 | $ 731,676 |
| Risk-weighted assets for | | |
| Credit risk | $ 4,068,823 | $ 3,423,017 |
| Operational risk | 480,873 | 354,250 |
| Total risk-weighted assets | $ 4,549,696 | $ 3,777,267 |
| Regulated capital to risk-weighted assets | | |
| Tier 1 capital | 17.3% | 18.1% |
| Tier 2 capital | 3.2% | 1.3% |
| Total regulatory capital ratio | 20.5% | 19.4% |
| Assets to regulatory capital multiple | 14.4 | 10.5 |

1 Accumulated other comprehensive loss relates to unrealized losses on certain available for sale equity securities, net of tax, which decrease Tier 1 capital.

2 The Company is allowed to include its collective allowance for credit losses up to a prescribed percentage of risk-weighted assets in Tier 2 capital. At December 31, 2011, the Company's collective allowance represented 0.65% of risk-weighted assets.

3 Accumulated other comprehensive income relates to unrealized gains on certain available for sale equity securities, net of tax, which increase Tier 2 capital.

4 Regulatory capital and calculations as at December 31, 2010 are based on previous Canadian GAAP balances.

**Table 32: Risk-weighted Assets (RWA) (Based only on the subsidiary, Home Trust Company)**

| (000s, except %) | Balance Sheet Amounts | Risk Weighting | Risk-weighted Amount |
|---|---|---|---|
| | | | **2011** |
| Cash and claims on or guaranteed by Canadian and provincial governments (including CMHC-insured mortgages) | **$ 9,285,116** | **0%** | **$ –** |
| Claims on banks and municipal governments | **591,098** | **20%** | **118,219** |
| Conventional mortgages on owner-occupied residences | **5,757,457** | **35%** | **2,015,110** |
| *Visa* secured and consumer loans | **330,516** | **75%** | **247,887** |
| Commercial mortgages, equities and other assets | **1,669,860** | **100%** | **1,669,860** |
| Non-performing commercial loans | **947** | **150%** | **1,421** |
| Total assets subject to risk rating | **17,634,994** | **–** | **–** |
| Collective allowance | **(29,440)** | **–** | **–** |
| Total assets | **17,605,554** | | **4,052,497** |
| Off-balance sheet items | | | |
| Loan commitments | **287,199** | **0%** | **–** |
| Interest rate contracts | **81,629** | **20%** | **16,326** |
| Total credit risk | **17,974,382** | | **4,068,823** |
| Operational risk | **–** | | **480,873** |
| Total | **$ 17,974,382** | | **$ 4,549,696** |

| (000s, except %) | Balance Sheet Amounts | Risk Weighting | Risk-weighted Amount |
|---|---|---|---|
| | | | 2010[1] |
| Cash and claims on or guaranteed by Canadian and provincial governments (including CMHC-insured mortgages) | $ 1,597,548 | 0% | $ – |
| Claims on banks and municipal governments | 515,316 | 20% | 103,063 |
| Conventional mortgages on owner-occupied residences | 3,415,969 | 35% | 1,195,589 |
| *Visa* secured and consumer loans | 251,193 | 75% | 188,395 |
| Commercial mortgages, equities and other assets | 1,923,776 | 100% | 1,923,776 |
| Non-performing commercial loans | 155 | 150% | 233 |
| Total assets subject to risk rating | 7,703,957 | – | – |
| Collective allowance | (29,153) | – | – |
| Total assets | 7,674,804 | | 3,411,056 |
| Off-balance sheet items | | | |
| Loan commitments | 540,363 | 0% | – |
| Interest rate contracts | 59,807 | 20% | 11,961 |
| Total credit risk | 8,274,974 | | 3,423,017 |
| Operational risk | – | | 354,250 |
| Total | $ 8,274,974 | | $ 3,777,267 |

[1] RWA calculations as at December 31, 2010 are based on previous Canadian GAAP balances.

Home Trust's Tier 1 and Total capital ratios continue to significantly exceed OSFI's well-capitalized targets of 7.0% for Tier 1 and 10.0% for Total capital, as well as Home Trust's internal capital targets.

Risk-weighted assets are determined by applying the OSFI prescribed rules to on-balance sheet and off-balance sheet exposures. These rules generally follow the international rules of the BIS widely known as Basel II. For the purposes of calculating credit risk-weighted assets, the Company follows the standardized approach, and for operational risk the Company follows the basic indicator approach. Over the year, risk-weighted assets increased by $772.4 million due to growth in conventional mortgages, *Visa* and consumer loans. The operational risk factor in the calculation has also increased as the Company's gross income, on which the calculation is based, has increased.

Home Trust elected to apply OSFI's IFRS transitional relief to the IFRS opening retained earnings adjustment. Home Trust is permitted to amortize the effect of the transition adjustment on regulatory capital over the eight quarters ending December 31, 2012. The amount added to regulatory capital will reduce to zero over this time. In the absence of this election Tier 1 and Total capital would have been $737.4 million and $881.9 million, respectively, resulting in Tier 1 and Total capital ratios of 16.2% and 19.4%.

### Basel III

The Company's management continues to closely monitor the capital and liquidity proposals widely known as Basel III. It is expected that these rules will be phased in beginning in 2013. The Company has completed an analysis of the proposed Basel III requirements and has identified the following components as applicable:

> *Liquidity Coverage Ratio (LCR)*. The LCR establishes a common measure of liquidity risk and requires institutions to maintain sufficient liquid assets to cover a minimum of 30 days of cash flow requirements in a stress situation. As at December 31, 2011 the Company had sufficient liquid assets to meet the minimum LCR.

> *Net Stable Funding Ratio (NSFR).* The NSFR establishes a second common measure of liquidity based on longer-term assets to longer-term liabilities. As at December 31, 2011 the Company had sufficient long-term funding to meet the minimum NSFR.

> *Tier 1 Capital.* Basel III proposes a number of deductions from Tier 1 capital that begin in 2014 with a 20% reduction, climbing to a 100% deduction in 2018. In particular, unconsolidated investments in financial institutions will result in a deduction from capital. After accounting for all deductions, Home Trust's capital ratios would continue to meet minimum and well capitalized levels.

> *Conservation Buffer and Counter-cyclical Buffer.* A capital conservation buffer of common equity equal to 2.5% of risk-weighted assets (RWA) will be phased in between 2016 and 2019 and will ultimately require a minimum tangible common equity ratio of 7.0% and a Total capital ratio of 10.5%. As at December 31, 2011 Home Trust had sufficient capital resources to adopt the conservation buffer. A further counter-cyclical buffer with a range of 0% to 2.5% of RWA in common equity will be required, based on national circumstances with the intent of preventing overheating or asset bubbles. As at December 31, 2011 Home Trust had sufficient capital resources to adopt the counter-cyclical buffer at the top of the range.

### Capital Management Activity

On May 4, 2011 the Company issued $150.0 million in long-term senior debt. Of the net proceeds, $100.0 million was provided to Home Trust as subordinated debt to enhance its regulatory capital position and support future growth. An additional $45.0 million was provided to Home Trust in early 2012 to further enhance its regulatory capital position and support growth objectives.

On September 12, 2011 the Company filed a new Normal Course Issuer Bid through the Toronto Stock Exchange, which allowed it to purchase over a 12-month period up to 10% of the public float outstanding on August 31, 2011. The Company believes that, from time to time, the market price of its common shares does not fully reflect the value of its business and its future business, and the repurchase of shares may represent an appropriate and desirable business decision.

During fiscal 2011, the Company repurchased 156,300 common shares (2010 – 197,000 common shares) for an amount of $7.9 million, thereby reducing retained earnings by $7.7 million and share capital by $0.2 million (2010 – $8.2 million and $0.3 million, respectively).

### Internal Capital Adequacy Assessment Process (ICAAP)

Under the Company's capital and risk management policies, and OSFI guidelines, it periodically, but no less than annually, is required to assess the adequacy of current and projected capital resources under expected and stressed conditions. This involves evaluating the Company's strategy, financial plan and risk appetite; assessing the effectiveness of its risk and capital management practices (including Board and senior management oversight); subjecting the Company's plans to a range of stress tests; and concluding on capital adequacy (including a rigorous review and challenge). Based on the Company's ICAAP, management has concluded that Home Trust is adequately capitalized.

### Credit Ratings

The following table presents the credit ratings for the Company and its subsidiary Home Trust. These investment-grade credit ratings would allow the Company to obtain institutional debt financing should the need arise for additional capital. During 2011 Standard & Poor's (S&P) and Fitch reaffirmed the credit ratings of the Company and Home Trust. In 2011 the Company and Home Trust received new ratings from Dominion Bond Rating Service (DBRS).

**Table 33: Credit Rating**

| | Home Capital Group Inc. | | | Home Trust Company | | |
|---|---|---|---|---|---|---|
| | DBRS | Standard & Poor's | Fitch Rating | DBRS | Standard & Poor's | Fitch Rating |
| Long-term rating | BBB | BBB | BBB | BBB (high) | BBB+ | BBB |
| Short-term rating | R2 (middle) | A-2 | F2 | R2 (high) | A-2 | F2 |
| Outlook | Stable | Stable | Stable | Stable | Stable | Stable |

### 2012 Outlook for Capital Management

The Company remains committed to maintaining its financial strength, strong capital ratios and a growing capital base throughout 2012 and beyond. The inclusion of mortgages securitized after March 31, 2010 in the ACM makes this measure the Company's primary capital constraint. The Company will continue to proactively monitor and assess its ACM on an ongoing basis.

## RISK MANAGEMENT

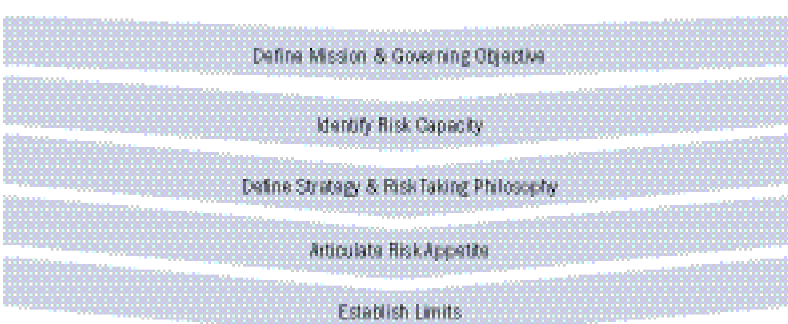
The shaded areas of this MD&A represent a discussion of risk management policies and procedures relating to credit, market and liquidity risks that are required under IFRS 7 *Financial Instruments: Disclosures* which permits these specific disclosures to be included in the MD&A. Therefore, the shaded areas presented in this Risk Management section form an integral part of the audited consolidated financial statements for the year ended December 31, 2011.

Risk management is an essential component of the Company's strategy, contributing directly to the Company's profitability and consistently high return on equity. The Company continues to invest significantly in risk management practices.

The Company's business strategies and operations expose the Company to a wide range of risks that could adversely affect its operations, financial condition, or financial performance, and which may influence an investor to buy, hold, or sell the Company's shares. Nevertheless, all businesses, in particular financial institutions, must accept some level of risk in their activities if they expect to make a profit and therefore must continuously make decisions that balance risk and reward. When evaluating risks, the Company will make decisions about which risks it will accept, which risks it will mitigate, offset or hedge, and which risks it will avoid. These decisions are guided by the Company's risk appetite framework.

### Risk Appetite

The Company follows a risk appetite framework that sets out the amount and types of risk the Company will take in pursuit of its business objectives and strategies. The Company's risk appetite framework has five major components as follows:




The Company's risk appetite framework, which was substantially revised and adopted in the fourth quarter of 2011, provides the structure to link the objectives of the Company's key stakeholders with the level of risk the Company can, and is willing, to take as follows:

1. Clearly define the Company's overall mission and objectives, given key stakeholder concerns. The level of risk inherent in these objectives drives the level of risk the Company may take.
2. Identify the Company's risk capacity by identifying the supply of capital capable of supporting risk and absorbing loss. Risk capacity is limited by other factors including regulatory constraints.

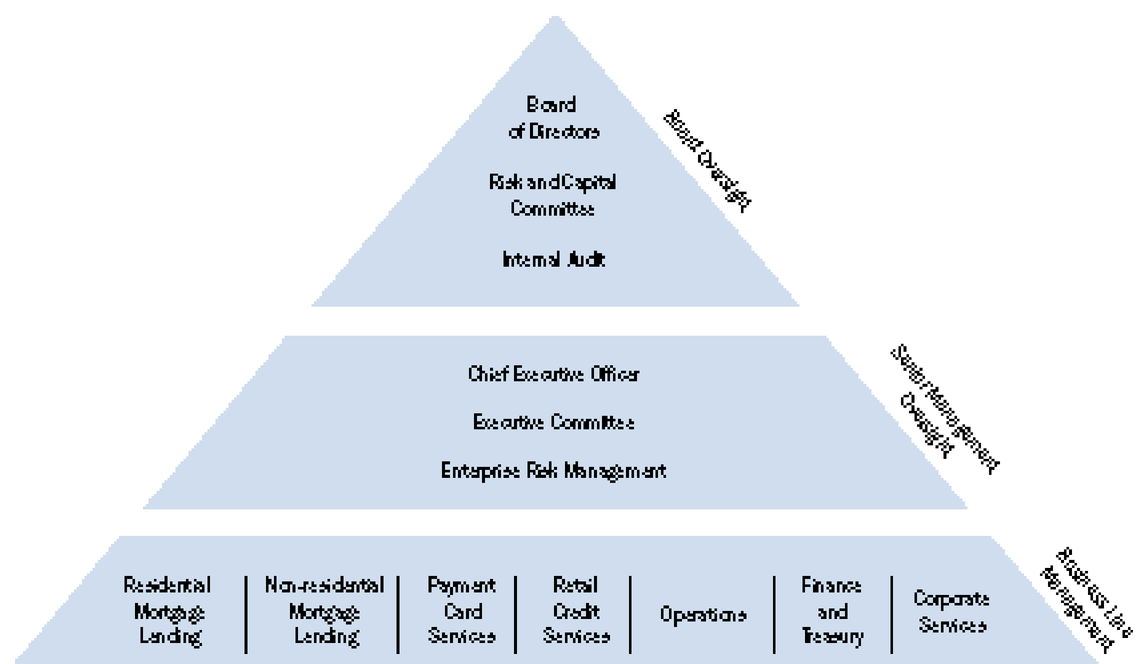
3. Identify the risks inherent in the corporate strategy supporting the mission and the governing objectives of the Company and establish a risk-taking philosophy that sets out the key principles that guide how the Company may take and mitigate risk.
4. Articulate the amount and types of risk the Company may take given its mission, risk capacity, strategy and risk-taking philosophy. The Company explicitly articulates Balance Sheet risk appetite (how much of the Company's capital it will put at risk), Portfolio Composition risk appetite (the types of risk the Company will take) and Non-financial risk appetite (expressions of risk appetite that are difficult to quantify). Among others, the Company has established risk appetite statements addressing
   - maximum capital at risk and minimum capital ratios;
   - maximum leverage or asset to capital multiple;
   - maximum amount of top level individual risk types; and
   - reputational risk.
5. Establish risk limits as an expression of the Company's risk appetite for individual risks or factors that contribute to risk levels (e.g. geographic concentrations, single names).

### Risk Governance

The Company's strategies and management of risk are supported by an overall enterprise risk management (ERM) framework and supporting frameworks for each major category of risk to which it is exposed (credit, market and operational). The Company defines ERM as an ongoing process involving its Board of Directors, management and other personnel in the identification, measurement, assessment and response to risks that may positively or negatively impact the organization as a whole. ERM is applied in strategy setting across the enterprise and is designed to provide reasonable assurance that the Company's objectives can be realized given its stated risk appetite. The goal of ERM is to help maximize, within the Company's risk appetite, the benefit to the enterprise, shareholders and other stakeholders from a portfolio of risks that the Company is willing to accept.

Supporting the Company's ERM structure is a risk culture and a governance framework, including Board and senior management oversight and an increasingly robust set of risk policies, standards and guidelines reflective of the Company's risk appetite, which set boundaries on acceptable business strategies, exposures and activities. The Company's governance structure is founded on three lines of defense. Authority is delegated by the Board of Directors through the Chief Executive Officer to business units that are responsible for managing the risk they take in the pursuit of their business objectives. The ERM group provides policy guidance to business units and helps ensure that all risks are monitored, measured, assessed and reported to senior management and the Board. Internal Audit provides objective reviews of the risk management process, its controls, and the effectiveness of those controls.

The governance structure as depicted in the figure below ensures that there is a framework in place for risk oversight and accountability across the organization. Risk owners are responsible for developing and executing strategies for controlling risk.



The Board is accountable for establishing the overall mission, objectives and strategies of the Company and setting the Company's risk appetite and risk-bearing capacity. It challenges management's proposals and plans to ensure that the forecast results and risk assessments are reasonable and in line with the Company's capabilities, objectives and risk appetite. These risk management responsibilities are primarily carried out through the Risk and Capital Committee of the Board. In this oversight role the Committee is designed to ensure that all significant risks to the Company, regardless of sources, are proactively identified and managed. This is accomplished by reviewing and approving, on at least an annual basis, all key risk policies; monitoring, on at least a quarterly basis, the Company's actual exposures versus Board-approved risk appetite and limits; and providing direction to management where deemed necessary. It further ensures that the ERM function is adequately independent of the businesses activities it oversees and that an appropriate, independent monitoring and reporting framework is in place and operating effectively so as to deliver accurate, timely and meaningful risk information for its review and evaluation.

The Executive Committee (EC), chaired by the Chief Executive Officer, is responsible for recommending corporate strategy to the Board and for overseeing its execution. A critical component of this mandate is recommending to the Risk and Capital Committee of the Board a risk appetite that aligns with the objectives and strategy of the Company. The EC is accountable for establishing an appropriate "risk aware" culture and proactively monitoring actual exposures and business activities in comparison to risk appetite. The EC reviews and validates the Company's portfolio of key risk exposures through comprehensive risk reporting as well as by an ongoing risk identification and assessment process, which is executed no less than quarterly. Through this process, significant risks are identified in light of current business, market, and economic conditions, ensuring that the risks the Company manages and monitors are not static but evolving in context with the greatest likelihood of impact on the Company at any given point in time.

The most significant risks to the Company are subject to more specific review, monitoring and assessment under the mandates of supporting risk committees. These committees (Consumer Credit, Asset-Liability Management and Operational Risk) recommend policies and standards for approval as proposed by ERM and proactively monitor and assess the specific risks under their mandates compared to the approved risk appetite. In addition to the Executive Committee and the supporting risk committees, the Company's risk governance is supported by:

> The Chief Risk Officer and the ERM group. The ERM group is mandated to work with the executive team and the Board of Directors of the Company to support sustainable business performance through the independent identification, measurement, assessment and monitoring of all significant risks to the Company, regardless of source. The ERM group recommends Home Capital's overall risk appetite, and limits reflecting the Company's risk appetite. It develops policy, management standards and guidelines to address significant risks and recommends Board and/or management approval. ERM independently maintains a current view of Home Trust's risk profile by monitoring actual exposure and practice against approved risk appetite, limits and policies, standards and guidelines.

> The Chief Compliance Officer and the Compliance group. Compliance is mandated to implement enterprise-wide compliance measures to mitigate reputational and regulatory risks (including anti-money laundering requirements), to promote a compliance culture and to report to Company management and the Board on compliance with the code of conduct and applicable material regulatory requirements.

> The Senior Vice President, Internal Audit, and the Internal Audit department. Internal Audit is mandated to independently assess and report to the Audit Committee, the Board of Directors and management on the effectiveness of risk management, internal controls and compliance with laws and regulations.

In order to integrate the Company's risk and control processes, management has formed the Governance, Risk and Compliance Committee to review and align the management structure, resources, processes and controls to match the size, complexity, scope, and risk profile of the organization. This committee makes recommendations to the Executive Committee to improve, operate and sustain all aspects of governance, risk and compliance.

### Stress Testing

In addition to the day-to-day risk management practices, a key component of the ERM framework is stress testing and scenario analysis. Management regularly evaluates a range of extreme but plausible scenarios and stress tests to evaluate the potential impact of these events and the effectiveness of management's contingency plans to deal with these unlikely but severe events, and the ability to mitigate the potential risk. A common set of scenarios is developed to assess the impact on the Company's financial results, capital positions, and operational capabilities to respond to the event. In particular, management has evaluated a range of economic scenarios, including a real estate-driven recession.

### Credit Risk

Credit risk is the risk of the loss of principal and/or interest from the failure of debtors and/or counterparties to honour their financial or contractual obligations to the Company, for any reason. The Company's overall exposure to credit risk is governed by credit specific risk appetite, limits and the Credit Risk Policy as approved by the Board. Senior management, the ERM group, the Audit Committee and the Risk and Capital Committee of the Board oversee the credit portfolio through ongoing reviews of credit risk management policies, lending practices, portfolio composition and risk profile, and the adequacy of loan loss reserves and credit-risk based capital. Credit risk limits are established for all types of credit exposures and include risk-sensitive, single-name limits in the Company's non-residential mortgage portfolio, as well as geographic, product, property and security type limits over all classes of exposure. The Company's risk management policy limits the total aggregate exposure to any entity or connection. The lines of business are responsible for managing the Company's credit risks in accordance with approved policies, and assess overall credit conditions and exposures on an ongoing basis. ERM recommends credit policies and standards, establishes specific underwriting guidelines and provides independent enterprise-wide oversight to all credit risks, including the independent measurement, monitoring and reporting of these risks.

On a transaction level the Chief Executive Officer, President and Chief Credit Officer are delegated authority by the Board of Directors to extend credit within the bounds of the Company's credit risk policies. The Company's policies require that credit is approved by different levels of senior management, based upon the level of risk and amount of the loan, and, without exception, require the independent concurrence of the Credit department, led by the Chief Credit Officer. A foundation of the Company's approach to credit is a high level of due diligence on each individual transaction. All transactions are subject to detailed reviews of the underlying security, an assessment of the applicant's ability to service the loan, and the application of a standard risk rating or credit score.

As part of credit risk management of the loan portfolio, senior management and the ERM function monitor various characteristics including the characteristics in the following table.

**Table 34: Credit Risk Portfolio Monitors**

| (000s, except % and number of credit cards issued) | **2011** | 2010 |
|---|---|---|
| Total loans balance (net of individual allowances) | **$ 16,089,648** | $ 14,091,755 |
| **Mortgage Portfolio** | | |
| Total mortgage portfolio balance (net of individual allowance) | **$ 15,529,455** | $ 13,638,416 |
| Percentage of residential mortgages of total mortgages | **93.9%** | 93.9% |
| Percentage of non-residential mortgages of total mortgages | **6.1%** | 6.1% |
| Percentage of insured residential mortgages | **61.0%** | 72.8% |
| Percentage of mortgages current | **97.3%** | 98.2% |
| Percentage of mortgages over 90 days past due | **0.4%** | 0.3% |
| Percentage of new residential originations insured | **26.1%** | 62.2% |
| Loan to value of residential mortgages (current) | **70.0%** | 69.6% |
| **Credit Card Portfolio** | | |
| Total credit card portfolio balance | **$ 386,971** | $ 339,872 |
| Percentage of Equityline *Visa* credit cards | **97.8%** | 97.5% |
| Percentage of secured credit cards | **2.2%** | 2.4% |
| Percentage of credit cards current | **96.8%** | 95.1% |
| Percentage of credit cards over 90 days past due | **1.4%** | 2.5% |
| Loan to value of Equityline *Visa* | **71.3%** | 72.3% |
| *Visa* card security deposits | **$ 13,219** | $ 12,138 |
| Total authorized limits of credit cards | **$ 476,576** | $ 416,388 |
| Total number of credit cards issued | **26,560** | 21,447 |
| Average balance authorized | **$ 18** | $ 19 |

Credit risk mitigation is a key component of the Company's approach to credit risk management. The composition of the mortgage portfolio is well within the internal policy limits approved by the Company's Risk and Capital Committee.

Insured mortgages reduce the credit risk to the Company. The insured portion of the mortgage portfolio has declined from December 31, 2010 due to a higher proportion of originations in the Company's traditional mortgage products, which are generally not insured. Mortgages in the traditional program have lower loan to value ratios than does the insured Accelerator product. For 2011 the average loan to value ratio on origination of the uninsured mortgage product was 69.6%, compared to 68.9% last year.

The Company manages credit risk on residential mortgages through collateral in the form of real property. In that regard, first mortgages continue to represent almost the entire portfolio. At December 31 2011, the average loan to value ratio of the total portfolio, which includes both insured and uninsured mortgages, was 70.0% compared to 69.6% last year. These loan to value ratios were calculated under the assumption that, unless the collateral related to a specific mortgage were reappraised, the value of the collateral on each mortgage would remain at the original appraised amount.

The relative proportion of non-residential mortgages was relatively stable over the last twelve months. As a proportion of the total portfolio, the Company anticipates that the non-residential portfolio will remain relatively stable or exhibit modest growth in the foreseeable future. The Company slowly began increasing its exposure to non-residential mortgage lending in 2010 and into 2011 in proportion with growth in the overall asset portfolio. The composition of residential to non-residential portfolios is well within the internal policy limits approved by the Company's Risk and Capital Committee and the Board of Directors.

Senior management and ERM closely monitor the credit performance of the mortgage loans portfolio. The portfolio continues to perform well, with arrears that are well within expected levels. At the end of 2011, 97.3% of the portfolio was current and 0.5% was over 60 days in arrears, which is within historical norms and expectations.

Personal and credit card loans were $560.2 million or 3.5% of the total loan portfolio at December 31, 2011 compared to $453.3 million or 3.2% at December 31, 2010. The gross credit card receivable balance was 69.1% of the personal and credit card portfolio, virtually all of which is secured by either cash deposits or residential property. Within the secured credit card portfolio, Equityline *Visa* credit cards represent the principal driver of receivable balances. Equityline *Visa* credit cards are secured by collateral residential mortgages, and this portfolio segment amounted to $378.3 million, or 97.8% of the total credit card receivable balance at the end of 2011, compared to 97.5% at the end of 2010. Cash deposits for secured credit card accounts are included in the Company's deposit liabilities. Additionally, the Equityline *Visa* portfolio had a loan to value ratio of 71.3% at the end of 2011, compared to 72.3% at the end of 2010.

Retail credit is secured by charges on financed assets, principally improvements to residential property or fixtures, such as water heaters. Water heater loans are guaranteed by the supplier, a highly rated credit risk.

Senior management and ERM closely monitor the credit performance of the credit card portfolio. The portfolio continues to perform well with arrears that are well within expected levels. At December 31, 2011, $6.8 million or 1.8% of the credit card portfolio was over 60 days in arrears, compared to $10.3 million or 3.0% at December 31, 2010.

Refer to Note 5(a) of the consolidated financial statements for a breakdown of the loan portfolio by geographic region. While the Company's overall strategy is to increase the geographic diversification of the loan portfolio, this has been tempered by credit conditions in some regional markets, leading to reduced distribution of loans in western Canada.

**Table 35: Non-Performing Loans**

| (000s, except %) | **2011** | | 2010 | | Change | |
|---|---|---|---|---|---|---|
| | **Gross** | **Net[1]** | Gross | Net[1] | Gross | Net[1] |
| Residential mortgages | **$ 36,845** | **$ 36,103** | $ 29,586 | $ 27,829 | 24.5% | 29.7% |
| Non-residential mortgages | **822** | **744** | 2,295 | 2,295 | (64.2%) | (67.6%) |
| Personal and credit card loans | **4,144** | **3,450** | 7,241 | 4,101 | (42.8%) | (15.9%) |
| Non-performing loans | **$ 41,811** | **$ 40,297** | $ 39,122 | $ 34,225 | 6.9% | 17.7% |
| Total gross loans | **$ 16,091,162** | | $ 14,096,652 | | 14.1% | |
| Net non-performing loans as a % of gross loans | | **0.25%** | | 0.24% | | |
| Total allowance for credit losses | | **$ 31,299** | | $ 34,453 | | |
| Total allowance as a % of gross loans | | **0.19%** | | 0.24% | | |
| Total allowance as a % of gross non-performing loans | | **74.86%** | | 88.07% | | |

[1] Non-performing loans are net of individual allowances as shown in Table 36 Allocaton of Allowance for Credit Losses.

Net non-performing loans remain within expected and acceptable ranges. As part of the Company's ongoing business strategy, experienced employees, in conjunction with ERM, undertake reviews of all non-performing loans greater than 60 days to analyze patterns and drivers, and then reflect emerging drivers in the Company's lending criteria. This analytical approach and attention to emerging trends has resulted in continued low write-offs relative to the gross loans portfolio. Write-offs, net of recoveries, totalled $10.7 million or 0.07% of gross loans in 2011, compared to $5.7 million or 0.04% of gross loans in 2010. In 2010, the Company experienced higher than expected recoveries, which reduced the net write-offs, and in 2011 the Company wrote off $2.0 million in Equityline *Visa* accounts due to an isolated fraud. The Company continually monitors arrears and write-offs and deals prudently and effectively with non-performing loans.

**Table 36: Allocation of Allowance for Credit Losses**

| (000s) | 2011 Opening Balance | Write-offs Net of Recoveries | Provision for Credit Losses | 2011 Ending Balance |
|---|---|---|---|---|
| Individual allowances | | | | |
| Residential mortgages | $ 2,160 | $ (7,263) | $ 6,190 | $ 1,087 |
| Non-residential mortgages | – | – | 78 | 78 |
| Personal and credit card loans | 3,140 | (3,410) | 964 | 694 |
| | 5,300 | (10,673) | 7,232 | 1,859 |
| Collective allowance | | | | |
| Residential mortgages | 16,299 | – | – | 16,299 |
| Non-residential mortgages | 9,357 | – | (57) | 9,300 |
| Personal and credit card loans | 3,497 | – | 344 | 3,841 |
| | 29,153 | – | 287 | 29,440 |
| Total allowance for credit losses | $ 34,453 | $ (10,673) | $ 7,519 | $ 31,299 |

| (000s) | 2010 Opening Balance | Write-offs Net of Recoveries | Provision for Credit Losses | 2010 Ending Balance |
|---|---|---|---|---|
| Individual allowances | | | | |
| Residential mortgages | $ 1,866 | $ (3,835) | $ 4,129 | $ 2,160 |
| Non-residential mortgages | 135 | – | (135) | – |
| Personal and credit card loans | 961 | (1,898) | 4,077 | 3,140 |
| | 2,962 | (5,733) | 8,071 | 5,300 |
| Collective allowance | | | | |
| Residential mortgages | 19,948 | – | (3,649) | 16,299 |
| Non-residential mortgages | 4,398 | – | 4,959 | 9,357 |
| Personal and credit card loans | 3,447 | – | 50 | 3,497 |
| | 27,793 | – | 1,360 | 29,153 |
| Total allowance for credit losses | $ 30,755 | $ (5,733) | $ 9,431 | $ 34,453 |

The allowance for credit losses has been established to cover identified losses and identified credit events in the loans portfolio.

Individual allowances represent the amount on identified non-performing loans required to reduce the carrying value of those loans to their estimated realizable amount. The balance will fluctuate from time to time and is driven by the performance of individual loans and the realizable value of the underlying security.

The collective allowance for credit losses is established for future losses inherent in the portfolio that are not presently identifiable on a loan-by-loan basis and reflects the relative risk of the various loan portfolios that the Company manages. The Company maintains a collective allowance that, in management's judgement, is sufficient to absorb probable incurred losses in its loans portfolio. At December 31, 2011 the Company held a collective allowance of $29.4 million, marginally higher than the $29.2 million held at December 31, 2010. The Company monitors the adequacy of the collective allowance on a monthly basis. The Company has security in the form of real property or cash deposits against loans, representing virtually all of the total loans portfolio. The Company's evaluation of the adequacy of the collective allowance takes into account asset quality, borrowers' creditworthiness, property location, past loss experience, current and forecasted probability of default and exposure at default based on product, risk ratings and credit scores, and current economic conditions. The Company periodically reviews the methods utilized in assessing the collective allowance, giving due consideration to changes in economic conditions, interest rates and local housing market conditions. As these factors change, the methodologies used by the Company to support the testing of the adequacy of the collection allowance will evolve.

### 2012 Outlook for Credit Risk

Please refer to the 2012 Outlook for Provision for Credit Losses section included in the Financial Performance Review section of this MD&A.

### Liquidity and Funding Risk

This is the risk that the Company is unable to generate or obtain cash or equivalents in a timely manner and at a reasonable cost to meet its commitments (both on- and off-balance sheet) as they become due. This risk will arise from fluctuations in the Company's cash flows associated with lending, deposit-taking, investing and other business activities.

The Company's liquidity management framework includes liquidity and funding policies, standards and guidelines that are approved by the Executive Committee and the Risk and Capital Committee of the Board of Directors. The Company has an Asset and Liability Committee (ALCO) whose mandate includes establishing and recommending to the Board an enterprise-wide liquidity risk appetite. In addition, the ALCO reviews the composition and term structure of assets and liabilities, reviews liquidity and funding policies and strategies and regularly monitors compliance with those policies. The ALCO also oversees the stress testing of liquidity and funding risk and the testing of the Company's liquidity risk contingency plan. The Treasury group is responsible for managing the Company's liquidity and funding positions in accordance with approved policies and assesses the impact of market events on liquidity requirements on an ongoing basis. ERM recommends liquidity policies and standards, and provides independent enterprise-wide oversight to all liquidity and funding risk.

The Company's liquidity and funding policies are designed to ensure that cash balances and its inventory of other liquid assets are sufficient to meet all cash outflows both in ordinary market conditions and during periods of extreme market stress. The Company's policies address several key elements, such as the minimum levels of liquid assets to be held at all times; the composition of types of liquid assets to be maintained; daily monitoring of the liquidity position by Treasury, senior management, and the ERM group; and quarterly reporting to the Risk and Capital Committee of the Board of Directors.

In 2010, the primary liquidity metric used to measure and monitor the Company's liquidity risk was total liquid assets as a percentage of 100-day liabilities. While this metric is still utilized, the Company began using a Net Cumulative Cash Flow (NCCF) liquidity horizon as its main liquidity metric in mid-2011. Using maturity gap analysis, the Company projects a time horizon when its NCCF turns negative, after taking into account the market value of its stock of liquid assets. The Company's liquidity horizon is calculated daily and is based upon contractual and behavioural cash flows. Forecasts are made using normal market conditions and a number of stressed liquidity scenarios. In addition, the Company regularly monitors a number of other structural liquidity and funding ratios in its overall liquidity and funding risk management framework.

The Company holds liquid assets in the form of cash, bank deposits, securities issued or guaranteed by the Government of Canada, securities issued by provincial governments, and highly rated short-term money market securities and corporate bonds and debentures. At December 31, 2011, liquid assets amounted to $763.3 million, compared to $951.3 million at December 31, 2010.

The Company's main sources of funding come from retail deposits and securitization. Retail deposits are primarily sourced through the deposit broker network. The broker network provides the Company access to a very large volume of potential deposits, which are sourced almost entirely from individual investors or small businesses with no reliance on wholesale funding markets. The bulk of deposits raised are fixed-term Guaranteed Investment Certificates (GICs) that are not subject to early redemption. It is the Company's conclusion that commissions paid to its broker network for deposit origination are considerably more cost effective and provide more efficient geographic distribution than would an increase in the number of Company-owned branches. The Company has contractual agreements with over 240 independent brokers, including most major national investment dealers. The Company continues to add new brokers in order to diversify its sources of funds.

The Company is an approved NHA MBS issuer and an approved seller into the CMB program, which are securitization initiatives sponsored by CMHC. Securitization funding provides the Company with long-term matched funding at very attractive interest rates. Traditionally, the Company has used securitization markets to fund its Accelerator mortgages and, to a lesser extent, its traditional mortgages that qualified for bulk portfolio insurance.

### 2012 Outlook for Liquidity and Funding Risk

The Company will continue to source deposits from the public through investment dealers and deposit brokers while seeking to expand this network through agreements with additional brokers that meet the Company's selection criteria and through additional products that meet the requirements for CDIC coverage. The Company anticipates that the overall size of available deposits in this channel will continue to increase in the medium to long term. However, it is also anticipated that competition amongst issuers may increase, possibly resulting in increased funding costs. The rate of growth in the deposit portfolio is expected to mirror the growth that is required to support the Company's traditional loan portfolio, while securitization will continue to support insured mortgages. Ensuring a reliable and sufficient source of deposits to fund operations and liquidity reserves will remain a key objective for the Company.

### Structural Interest Rate Risk

Structural interest rate risk is the risk of lost earnings or capital due to sudden changes in interest rates. The objective of interest rate risk management is to ensure that the Company is able to realize stable and predictable earnings over specific time periods despite interest rate fluctuations. The Company has adopted an approach to the management of its asset and liability positions to prevent interest rate fluctuations from materially impacting future earnings, and, to the best of its abilities, matches liabilities to assets through its actions in the deposit market in priority to accessing off-balance sheet solutions.

The Company's market risk management framework includes interest rate risk policies that are approved by the Executive Committee and the Risk and Capital Committee of the Board of Directors. The ALCO is responsible for defining and monitoring the Company's structural interest rate risk and reviewing significant maturity and/or duration mismatches, as well as developing strategies that allow the Company to operate within its overall risk tolerance. In addition, the ALCO oversees stress testing of structural interest rate risk using a number of interest rate scenarios. The Treasury group is responsible for managing the Company's interest rate gaps in accordance with approved policies and assesses the impact of market events on the Company's net interest income and economic value of shareholders' equity. The ERM group recommends prudential policies and standards, and provides independent enterprise-wide oversight to all interest rate risk.

From time to time, the Company enters into interest rate derivative transactions in order to hedge its structural interest rate risk. The use of derivative products has been approved by the Board of Directors; however, permitted usage is governed by specific policies. Derivatives are only permitted in circumstances in which the Company is hedging asset-liability mismatches, or loan commitments, or as a result of hedging requirements under the terms of its participation in the CMB program. Moreover, the policy expressly articulates that use of derivatives is not permitted for transactions that are undertaken to potentially create trading profits through speculation on interest rate movements.

The interest rate sensitivity position as at December 31, 2011 is presented under Note 21 in the consolidated financial statements. The table provided there represents these positions at a point in time, and the gap represents the difference between assets and liabilities in each maturity category. This note summarizes assets and liabilities in terms of their contractual amounts. Over the lifetime of certain assets, some contractual obligations such as residential mortgages will be terminated prior to their stated maturity at the election of the borrower, by way of prepayments. Similarly, some contractual off-balance sheet mortgage commitments may be made but may not materialize. In measuring its interest rate risk exposure, the Company makes assumptions about these factors, taking into account aspects such as past borrower history.

To assist in matching assets and liabilities, the Company utilizes two interest rate risk sensitivity models that measure the relationship between changes in interest rates and the resulting impact on both the future net interest income and the economic value of shareholders' equity. The objective is to manage the interest rate risk within guidelines.

The following table provides measurements of interest rate sensitivity and the potential after-tax impact of immediate and sustained 100 basis-point and 200 basis-point increases and decreases in interest rates on net interest income and on the economic value of shareholders' equity.

As illustrated in the following table, an increase in interest rates will have a positive impact on net interest income after tax increase the net present value of shareholder's equity in both a 100 and a 200 basis-point movement in rates. A positive gap exists when interest-sensitive assets exceed interest-sensitive liabilities on specific maturity or repricing periods. As these gaps widen the fluctuation in the sensitivity becomes more pronounced and, for this reason, the Company's ALCO manages this to within authorized limits.

**Table 37: 100 and 200 Basis Point Interest Rate Shift**

| | Increase in Interest Rates | | Decrease in Interest Rates | |
|---|---|---|---|---|
| As at December 31 (000s) | **2011** | 2010 | **2011** | 2010 |
| **100 basis point shift** | | | | |
| Impact on net interest income, after tax (for the next 12 months) | **$ 8,142** | $ 10,597 | **$ (8,142)** | $ (10,597) |
| Impact on net present value of shareholders' equity | **4,175** | 19,871 | **(5,914)** | (23,209) |
| **200 basis point shift** | | | | |
| Impact on net interest income, after tax (for the next 12 months) | **$ 16,284** | $ 21,194 | **$ (16,284)** | $ (21,194) |
| Impact on net present value of shareholders' equity | **6,696** | 36,627 | **(11,760)** | (52,632) |

### Investment Risk

Investment risk is the risk of loss due to impairment in the fair value of investments.

The Company's investment risk management framework includes investment policies which are approved by the Executive Committee and the Risk and Capital Committee of the Board of Directors. The ALCO is responsible for defining and monitoring the Company's investment portfolio and identifying investments that may be at risk of impairment. The Treasury group is responsible for managing the Company's investment portfolio in accordance with approved policies and assesses the impact of market events on potential implications to its total value. ERM recommends prudential policies and standards, and provides independent enterprise-wide oversight to all investment risk, including valuations.

### Operational Risk

Operational risk, which is inherent in all business activities, is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Operational risk includes legal risk, but excludes strategic and reputational risk. The impact of operational risk may include financial loss, loss of reputation, loss of competitive position, or regulatory penalties, among others. The Company is exposed to operational risks not only from internal business activities, but also from activities that are outsourced. While operational risk cannot be eliminated, the Company has taken proactive steps to mitigate this risk.

The Company's operational risk management framework includes operational risk policies that are approved by the Executive Committee and the Risk and Capital Committee of the Board of Directors. The Operational Risk Committee is responsible for defining and monitoring the Company's operational risk and reviewing significant operational key risk indicators as well as developing strategies that allow the Company to operate within its overall risk appetite. In addition, the Operational Risk Committee oversees the periodic execution and evaluation of operational risk stress tests and scenario analysis. The Company's business lines and operational groups are responsible for managing the Company's operational risk in accordance with approved policies and assessing the impact of internal and external events to the Company. The ERM group recommends prudential policies and standards, and provides independent enterprise-wide oversight to all operational risks, including the independent measurement, monitoring and reporting of these risks.

The Company also maintains appropriate insurance coverage through a financial institution bond policy, which is reviewed at least annually for changes to coverage and the Company's operations.

### Strategic and Business Risk

Strategic and business risk is the risk of loss due to fluctuations in the external business environment, the failure of management to adjust its strategies and business activities for external events or business results, or the inability of the business to change its cost levels in response to those changes. Strategic and business risk is managed by the Chief Executive Officer and the Executive Committee. On a regular basis, the Executive Committee reviews the current environment, the business results and the actions of the Company's competitors and adjusts business plans accordingly. The Board approves the Company's strategies at least annually and reviews results against those strategies at least quarterly.

### Reputational Risk

Reputational risk is the risk that an activity undertaken by the Company or its representatives will impair its image in the community or lower public confidence in it, resulting in a loss of business, legal action, or increased regulatory oversight. Such risk can arise from various possible events including those associated with strategic, credit and operational risk.

The Company views reputational risk as an exposure to earnings and/or capital from the consequence of or failure to adequately manage any risk, regardless of source, rather than a specific risk per se. Failure to effectively manage these risks can result in reduced market capitalization, loss of client loyalty, and the inability to achieve the Company's strategic objectives.

The most effective way for the Company, in taking a balanced view of risk, to safeguard its public reputation is through the successful management of the underlying risks in the business. The Company believes that the means to achieve this is through the adoption of an enterprise risk management framework.

### Regulatory and Legal Risk

Regulatory risk is the risk of a negative impact to business activities, earnings or capital, regulatory relationships or reputation as a result of failure to adhere to or comply with regulations or ethical standards. Legal risk is the risk of non-compliance with legal requirements, including the effectiveness in preventing or handling legal claims.

The financial services industry is heavily regulated with high standards expected in all of the Company's business dealings. As a result, the Company is exposed to regulatory risk in practically all of its activities. Failure to meet regulatory requirements not only poses a risk of regulatory constraints but also puts the reputation of the Company at risk.

Proactive management of regulatory risk is carried out through a dedicated regulatory relationship manager at the executive level, who in turn is supported by an entity-wide regulatory risk framework called the Legislative Compliance Management Framework (LCM). The Compliance group is responsible for LCM and, as such, is responsible for managing day-to-day regulatory risk. The Compliance group receives assistance when required from in-house counsel, internal audit and external counsel when needed.

Internal and external counsel work closely with the business units in daily operations to identify areas of potential legal risk, to draft and negotiate legal agreements to manage those risks, to provide advice on the performance of legal obligations under agreements and to manage litigation in which the Company is a party, as it arises.

### Risk Factors That May Affect Future Results

In addition to the risks described in this Risk Management section, there are numerous other risk factors, in particular macroeconomic and industry factors beyond the Company's control, which could cause the Company's results to differ significantly from the Company's plans, objectives and estimates. All forward-looking statements, including those in this MD&A, are, by their very nature, subject to inherent risks and uncertainties, general and specific, which may cause the Company's actual results to differ materially from the expectations expressed in the forward-looking statements. Some of these external factors are discussed below.

#### *Monetary and Fiscal Policy*

The Company's earnings are affected by the monetary policy of the Bank of Canada and the fiscal policy of the federal government of Canada and other governments in Canada and abroad. Changes in the supply of money, government spending and the general level of interest rates can affect the Company's profitability. A change in the level of interest rates affects the interest spread between the Company's deposits and loans and as a result impacts the Company's net interest income. Changes in monetary and fiscal policy and in the financial markets are beyond the Company's control and are difficult to predict or anticipate.

#### *Level of Competition*

The Company's performance is impacted by the level of competition in the markets in which it operates. The Company currently operates in a highly competitive industry. Customer retention can be influenced by many factors, such as the pricing of products or services, changes in customer service levels, changes in products or services offered, and general trends in consumer demand.

#### *Changes in Laws and Regulations*

Changes in laws and regulations, including interpretation or implementation, could affect the Company by limiting the products or services it can provide and increasing the ability of competitors to compete with its products and services. Also, the Company's failure to comply with applicable laws and regulations could result in sanctions and financial penalties that could adversely impact earnings and damage the Company's reputation.

#### *Information Systems and Technology*

The Company is highly dependent upon its information technology systems. The Company uses third-party software for its main operations and relies on third parties for credit card processing, Internet connections and access to external networks. Should the Company experience any major disruptions in connections for software, Internet or telecommunications for voice or data, this would impair its ability to provide service to clients. The longer and more severe the disruption, the more the Company's ability to conduct business would be impaired.

The Company completed the implementation of a new core banking system in 2011. The period immediately following a significant system conversion typically increases information technology-related risk. During this transition, the Company's information technology systems are subject to increased management oversight and information technology resources.

*Accounting Policies and Estimates Used by the Company*

The accounting policies and estimates the Company utilizes determine how the Company reports its financial condition and results of operations, and they may require management to make estimates or rely on assumptions about matters that are inherently uncertain. Such estimates and assumptions may require revisions, and changes to them may materially adversely affect the Company's results of operations and financial condition. More discussion is included in the Accounting Standards and Policies section and within the notes to the consolidated financial statements.

*Ability to Attract and Retain Employees and Executives*

The Company's future performance depends to a large extent on its ability to attract and retain key personnel. There is strong competition for the best people in the financial services sector. There is no assurance that the Company will be able to continue to attract and retain key personnel, although this remains a fundamental corporate priority.

## ACCOUNTING STANDARDS AND POLICIES

The significant accounting policies are outlined in Note 2 to the consolidated financial statements included in this report. These policies are critical as they refer to material amounts and require management to make estimates.

Critical accounting estimates that require management to make significant judgements, some of which are inherently uncertain, are outlined in Note 2 to the consolidated financial statements included in this report. These estimates are critical as they involve material amounts and require management to make determinations that, by their very nature, include uncertainties. The preparation of consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions, mainly concerning the valuation of items, which affect the amounts reported. Actual results could differ from those estimates. Key areas where management has made estimates include allowance for credit losses, fair values and impairment of financial instruments, goodwill and intangible assets, income taxes, fair value of stock options and useful lives of capital assets and intangible assets. Further information can be found under Notes 4, 5, 6, 8, 9, 10, 14, 16, 19 and 22 to the consolidated financial statements.

## INTERNATIONAL FINANCIAL REPORTING STANDARDS

### Impact of Adoption of International Financial Reporting Standards

*General*

The Company implemented revised Canadian GAAP, which uses International Financial Reporting Standards (IFRS) as its financial reporting framework, on January 1, 2011, with a transition date of January 1, 2010. Transition as at January 1, 2010 required restatement of the Company's 2010 financial information from its original Canadian GAAP basis to the IFRS basis. This allows for inclusion of comparative information in the 2011 financial statements. On transition, IFRS require the application of certain mandatory and optional transition exemptions. The details of the restatement and the mandatory and selected optional exemptions, which the Company applied on transition, are set out in Note 26 to the accompanying consolidated financial statements.

As IFRS represent a new accounting framework, it is generally not appropriate to directly compare the Company's financial position and results of operations as stated under IFRS to the financial position and results of operations as stated under previous Canadian GAAP.

While many of the accounting principles and standards comprising IFRS are similar to previous Canadian GAAP, certain standards and rules are fundamentally different, resulting in significant changes to previously reported financial results and financial position. The most significant differences relate to the accounting treatment of securitization transactions, including the timing of income and expense recognition, and the treatment of assets and liabilities arising from securitization activities. Under previous Canadian GAAP, the assets securitized by the Company were removed from the balance sheet, and a gain was calculated by comparing the fair value of consideration received and receivable to the carrying value of the assets at the time of securitization. The securitization transaction triggered income and expense recognition. Under IFRS, the proceeds received on the securitization are considered a secured loan. Interest income associated with the securitized assets is recognized on an effective interest rate method, amortizing origination costs over the term of the mortgage. Interest expense is recognized on the secured loan over the term of the securitization, amortizing transaction costs and the discount or premium over that term. Under IFRS, income and expenses are recognized with the passage of time.

As the Company has previously discussed, the restatement of the Company's financial results from previous Canadian GAAP to IFRS results in a significant adjustment related to certain derivatives that the Company uses to hedge interest rate risk associated with its securitization programs. The Company has generally used bond forwards and interest rate swaps to hedge interest rate risk associated with the commitments and accumulation of mortgages that are held for securitization and interest rate risk associated with the obligations assumed through the securitizations. Under previous Canadian GAAP, the hedging instruments and the hedged items were all carried at fair value, and changes in fair value tended to offset each other. Under IFRS, the hedging instruments used in 2010 must be accounted for at fair value, whereas the hedged items are accounted for at amortized cost. This results in an accounting mismatch. This mismatch has an impact on the measurement of income from quarter to quarter, with gains recognized in some quarters and losses in others. These gains and losses are not a reflection of an economic relationship, but rather an accounting mismatch. The Company has taken steps to eliminate or significantly reduce this mismatch in 2011. The Company analyzed its performance through 2011 by comparison to 2010 IFRS results, after adjustment, for this mismatch (adjusted net income and adjusted earnings per share).

### *Retained Earnings and Accumulated Other Comprehensive Income as at January 1, 2010*

On restatement of the Company's 2010 financial statements to the IFRS basis, the cumulative gains recognized on securitizations before January 1, 2010 have been deducted from retained earnings, while the net interest income attributed to the securitized assets and related debt accumulated to December 31, 2009 was added to retained earnings. This resulted in a net reduction of retained earnings as at January 1, 2010 of $75.6 million. Consequently, this amount will be recognized in future periods, including a portion in 2011. Accumulated other comprehensive income was reduced by $11.1 million to remove the fair value adjustments for the securitization receivables that are not part of the IFRS balance sheet.

### *Net Income and Earnings per Share*

As a result of the implementation of IFRS, net income recognized in 2010 was restated from $180.9 million to $154.8 million. This restatement included an unmatched pre-tax gain on derivatives of $7.1 million. On a basis that adjusts for the unmatched gain on derivatives, the net income for 2010 was $147.6 million. The Company's IFRS earnings per share for 2010 were $4.46 and $4.45 for basic and diluted, respectively, compared to $5.21 and $5.20 for basic and diluted under previous Canadian GAAP. On an adjusted net income basis, the IFRS basic and diluted earnings per share were $4.25 and $4.24. The Company uses adjusted net income and adjusted earnings per share for performance evaluation to eliminate the gains and losses on derivatives that arise from the adoption of the IFRS framework. For the most part, such gains and losses will not occur in 2011 or in future periods as a result of revised interest rate risk management procedures and the application of hedge accounting.

### *Net Interest Income and Net Interest Margin*

Under IFRS, all mortgages currently administered by the Company are included on the balance sheet, including securitized insured mortgages, along with a liability representing the funding of these mortgages through securitization. A significant portion of securitized mortgages are Accelerator mortgages, which generally carry lower interest rates than the Company's traditional mortgages and earn lower interest spreads against the funding. Consequently, while total interest income and net interest income increased on conversion to IFRS, the total net interest margin declined. The Company's net interest margin for 2010 was 2.07% on the IFRS basis, compared to 2.70% on the Canadian GAAP basis.

### *Return on Equity*

On restatement to the IFRS basis, the Company includes in liabilities the value of funds received on securitization of mortgage pools. The Company also reduced net income and the stated value of retained earnings and accumulated other comprehensive income as at January 1, 2010, as described above. On the IFRS basis, adjusted return on equity for 2010 was 26.1%, compared to 27.2% reported under Canadian GAAP.

### *Capital Measures*

The Company's Board of Directors, senior management and its prudential regulator, OSFI, set certain limits on the Company's activities based on measures of capital adequacy and leverage of Home Trust. The primary measures are Home Trust's Tier 1 and Total capital ratios and ACM. The conversion to IFRS does not significantly affect the Tier 1 and Total capital ratios. The regulatory requirement to include all assets under administration, except those securitized prior to March 31, 2010 under CMHC's CMB and MBS programs, has the impact of increasing the ACM at January 1, 2011 from 10.5 times under Canadian GAAP to 15.1 times under IFRS. In this regard, to maintain growth objectives, Home Trust increased its regulatory capital base in early May 2011 through the issue of $100.0 million in subordinated debt to Home Capital, which issued $150.0 million in external senior debt.

### *Other Assets and Liabilities and Other Performance Indicators*

The restatement of the Company's accounts and financial statements to the IFRS basis has an impact on other asset and liability categories and other performance indicators, such as credit ratios, credit provision ratios, efficiency ratio and return on assets. Readers are cautioned to take care when making comparisons to previous period reports.

### IFRS Operating Results and Key Performance Indicators for 2010

The following table provides the operating results and key performance indicators for 2010 under both IFRS and previous Canadian GAAP.

| | 2010 | |
|---|---|---|
| (000s, except % and multiples) | IFRS | Previous Canadian GAAP |
| **Net interest income non-securitized assets** | | |
| Non-securitized loans interest | $ 353,779 | $ 354,222 |
| Dividends and other interest | 28,010 | 28,010 |
| Interest on deposits | 188,370 | 188,370 |
| | 193,419 | 193,862 |
| **Net interest income securitized assets** | | |
| Securitized loans interest | 251,292 | – |
| Interest on securitization liabilities | 180,681 | – |
| | 70,611 | – |
| **Total net interest income** | 264,030 | 193,862 |
| Provision for credit losses | 9,431 | 9,411 |
| | 254,599 | 184,451 |
| **Non-interest income** | | |
| Fees and other income | 30,690 | 30,690 |
| Securitization income | – | 107,724 |
| Net gain on securities | 9,740 | 8,953 |
| Net gain on sale of loan portfolio | 3,917 | 3,917 |
| Net gain on derivatives[1] | 9,821 | 421 |
| | 54,168 | 151,705 |
| **Non-interest expenses** | 95,476 | 93,939 |
| Income before taxes | 213,291 | 242,217 |
| Income taxes | 58,539 | 61,273 |
| **NET INCOME** | $ 154,752 | $ 180,944 |
| **Basic earnings per share** | $ 4.46 | $ 5.21 |
| **Diluted earnings per share** | $ 4.45 | $ 5.20 |
| **Adjusted net income** | | |
| Adjustment for unmatched derivative positions (net of tax)[1] | $ (7,142) | $ – |
| **ADJUSTED NET INCOME** | $ 147,610 | $ 180,944 |
| **Adjusted basic earnings per share** | $ 4.25 | $ 5.21 |
| **Adjusted diluted earnings per share** | $ 4.24 | $ 5.20 |
| Adjusted return on shareholders' equity | 26.1% | 27.2% |
| Return on average assets[2] | 1.1% | 2.4% |
| Efficiency ratio (TEB)[3] | 29.3% | 26.6% |
| Net non-performing loans as a percentage of gross loans | 0.24% | 0.58% |
| Total net interest margin[4] | 2.07% | 2.70% |
| Provision as a percentage of gross loans | 0.07% | 0.16% |

1 The net gain on derivatives in 2010 results from the accounting mismatch discussed above under General Impacts of Adoption of IFRS. This amount is eliminated from net income on an after tax basis to arrive at adjusted net income.

2 This key performance indicator has not been recalculated based on adjusted net income.

3 The efficiency ratio is calculated as non-interest expenses as a percentage of total revenue, net of interest expense.

4 Numbers have been restated to reflect improvements in average balance calculations.

## ACCOUNTING DEVELOPMENTS

All accounting standards effective for periods beginning on or after January 1, 2011 have been adopted as part of the transition to IFRS. The following new IFRS pronouncements have been issued but are not effective and may have a future impact on the Company:

**IAS 1 *Presentation of Financial Statements***

Beginning with the 2013 annual financial statements, the Company will be required to adopt amendments to IAS 1 *Presentation of Financial Statements* which may result in changes in the way OCI is presented in the consolidated statement of income. Management is currently evaluating the potential impact that the adoption of IAS 1 will have on the presentation of Company's consolidated financial statements.

**IFRS 7 *Financial Instruments: Disclosures***

Beginning with the 2012 annual financial statements the Company will adopt amendments to IFRS 7 regarding disclosures about transfers of financial assets, which will require additional disclosures on transfer transactions of financial assets (e.g. securitization transactions). There will be no impact on the operating results or financial position of the Company as this standard affects disclosures only.

**IFRS 9 *Financial Instruments***

As of January 1, 2015 the Company will be required to adopt IFRS 9 *Financial Instruments* (IFRS 9), which is the first phase of the International Accounting Standards Board's (IASB) project to replace IAS 39, *Financial Instruments; Recognition and Measurement.* IFRS 9 provides new requirements for the way in which an entity should classify and measure financial assets and liabilities that are in the scope of IAS 39 *Financial Instruments*. Management is currently evaluating the potential impact that the adoption of IFRS 9 will have on the Company's consolidated financial statements.

**IFRS 10 *Consolidated Financial Statements***

As of January 1, 2013 the Company will be required to adopt IFRS 10 *Consolidated Financial Statements* (IFRS 10). Under IFRS 10, consolidated financial statements will include all controlled entities under a single control model. Management is currently evaluating the potential impact that the adoption of IFRS 10 will have on the Company's consolidated financial statements but does not anticipate any material changes to the financial position or operating results upon adoption of IFRS 10.

**IFRS 12 *Disclosure of Interests in Other Entities***

As of January 1, 2013 the Company will be required to adopt IFRS 12 *Disclosure of Interests in Other Entities* (IFRS 12). IFRS 12 provides disclosure requirements about subsidiaries, joint ventures and associates, as well as unconsolidated structured entities and replaces existing disclosure requirements. The requirements of IFRS 12 will not have an impact on the results of operations or financial position of the Company as they are disclosure requirements only.

**IFRS 13 *Fair Value Measurement***

As of January 1, 2013 the Company will be required to adopt IFRS 13 *Fair Value Measurement* (IFRS 13). IFRS 13 establishes a single source of guidance for fair value measurements when fair value is required or permitted by IFRS and provides for enhanced disclosures when fair value is applied. Management is currently evaluating the potential impact that the adoption of IFRS 13 will have on the Company's consolidated financial statements.

**IAS 27 *Separate Financial Statements***

As of January 1, 2013 the Company will be required to adopt the reissued IAS 27 *Separate Financial Statements* (IAS 27). As the consolidation guidance will now be included in IFRS 10, IAS 27 will only prescribe the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when the entity prepares separate financial statements. Management is currently evaluating the potential impact that the adoption of the reissued IAS 27 will have on the financial statements of the Company's subsidiaries.

## CONTROLS OVER FINANCIAL REPORTING

### Disclosure Controls and Internal Control over Financial Reporting

Management is responsible for establishing the integrity and fairness of financial information presented in the consolidated financial statements prepared in accordance with Canadian generally accepted accounting principles. As such, management has established disclosure controls and procedures and internal controls over financial reporting to ensure that the Company's consolidated financial statements and the Management's Discussion and Analysis present fairly, in all material respects, the financial position of the Company and the results of its operations.

### Disclosure Controls and Procedures

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is gathered and reported to senior management, including the Chief Executive Officer and Chief Financial Officer, on a timely basis so that appropriate decisions can be made regarding public disclosure.

An evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures was conducted as of December 31, 2011. Based on that evaluation, the Company's management, including the Chief Executive Officer and Chief Financial Officer, concluded that the Company's disclosure controls and procedures, as defined by National Instrument 52-109 *Certificate of Disclosure in Issuers' Annual and Interim Filing*, were effective as of December 31, 2011.

### Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. The Company's internal control over financial reporting includes policies and procedures that:

a. pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;
b. provide reasonable assurance that the transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and the receipts and expenditures are being made in accordance with authorizations of management and Directors of the Company; and
c. provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Due to inherent limitations, internal controls over financial reporting can provide only reasonable assurance and may not prevent or detect misstatements. As a result, the Company's management acknowledges that its internal control over financial reporting will not prevent or detect all misstatements due to error or fraud. Furthermore, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of a change in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

The Company has used the Committee of Sponsoring Organizations of the Treadway Commission (COSO) framework and COBIT, an IT governance framework, to evaluate the design of the Company's internal controls over financial reporting.

An evaluation of the design and operating effectiveness of internal controls over financial reporting was conducted as of December 31, 2011. Based on that evaluation, the Company's management, including the Chief Executive Officer and Chief Financial Officer, concluded that the Company's internal controls over financial reporting were operating effectively as of December 31, 2011.

### Changes in Internal Control over Financial Reporting

During the Company's transition period to IFRS, management identified and subsequently implemented certain changes to accounting processes and procedures in order to comply with IFRS. The material changes in processes and procedures relate to the following:

> Accounting for securitized mortgages on the Company's balance sheet.

> Accounting for the secured borrowing liability.

> Accounting for securitized mortgage interest income and secured borrowing interest expense.

> Application of hedge accounting for hedges of interest rate risk.

> Conversion of historical Canadian GAAP financial information to IFRS for comparative purposes.

As a result of these changes to accounting process and procedures, management revised existing internal controls and designed and implemented new internal controls over financial reporting to provide reasonable assurance that the risk of material misstatements in the Company's financial reporting has been mitigated.

During the third quarter of 2011, the Company began capturing, summarizing and reporting mortgage, deposit and expense transactions using a new financial system. The new system involved revisions to accounting processes. The Company's internal controls over financial reporting were modified as a result of the changes to these processes. Development of this system continued into the fourth quarter, and additional control modifications were made as required.

There were no other changes that have or could be reasonably expected to materially affect internal control over financial reporting.

## UPDATED SHARE INFORMATION

As at December 31, 2011, the Company had issued 34,624,690 common shares. In addition, outstanding employee stock options amounted to 928,500 (Note 14(d)) (1,065,500 – 2010) of which 594,000 were exercisable as of the end of the year (421,250 – 2010) for proceeds to the Company upon exercise of $20.4 million ($13.9 million – 2010).

This Management's Discussion and Analysis is dated February 14, 2012.

## NON-GAAP MEASURES

The Company has adopted IFRS as its accounting framework. IFRS are the GAAP for Canadian publicly accountable enterprises for years beginning on or after January 1, 2011. The Company uses a number of financial measures to assess its performance. Some of these measures are not calculated in accordance with GAAP, are not defined by GAAP, and do not have standardized meanings that would ensure consistency and comparability between companies using these measures. The non-GAAP measures used in this MD&A are defined as follows:

#### *Adjusted Net Income and Adjusted Earnings per Share*

Gains (losses), net of tax, that are associated with unmatched derivative volatility in 2010 and the loss recorded early in the first quarter of 2011 as the Company realigned its hedging strategy, are adjusted against net income to present adjusted net income. The adjustments to net income to calculate adjusted net income for these unmatched derivative positions were $nil for the fourth quarter of 2011 ($4.1 million gain in the fourth quarter of 2010), and a $2.4 million loss for 2011 ($7.1 million gain in 2010).

#### *Core Earnings*

Core earnings are a profitability measure that presents core earnings from lending operations. The Company calculates this measure as net interest income after provision for credit losses plus fees and other income.

#### *Adjusted Return on Shareholders' Equity*

Return on equity is a profitability measure that presents the adjusted net income (see above) available to common shareholders' equity as a percentage of the capital deployed to earn the income. The Company calculates its return on shareholder's equity using average common shareholders' equity, including all components of shareholders' equity.

### *Return on Assets*

Return on assets is a profitability measure that presents the annualized net income as a percentage of the average total assets for the period deployed to earn the income.

### *Efficiency or Productivity Ratio*

Management uses the efficiency ratio as a measure of the Company's efficiency in generating revenue. This ratio represents non-interest expenses as a percentage of total revenue, net of interest expense. The Company also looks at the same ratio on a taxable equivalent basis and will include this adjustment in arriving at the efficiency ratio, on a taxable equivalent basis. A lower ratio indicates better efficiency.

### *Net Interest Margin*

Net interest margin is calculated by taking net interest income, on a taxable equivalent basis, divided by average total assets generating the interest income.

### *Tier 1 and Total Capital Ratios*

The capital ratios provided in this MD&A are those of the Company's wholly owned subsidiary Home Trust Company. The calculations are in accordance with guidelines issued by OSFI. Refer to Note 14(h) to the consolidated financial statements included in this report.

### *Taxable Equivalent Basis (TEB)*

Most banks and trust companies analyze and discuss their financial results on a taxable equivalent basis (TEB) to provide uniform measurement and comparison of net interest income. Net interest income (as presented in the consolidated statements of income) includes tax-exempt income from certain securities. The adjustment to TEB used in this MD&A increases income and the provision for income taxes to what they would have been had the income from tax-exempt securities been taxed at the statutory tax rate. TEB adjustments of $7.2 million for 2011 ($7.9 million in 2010) increased the interest income used in the calculation of net interest margin. TEB does not have a standard meaning prescribed by GAAP and therefore may not be comparable to similar measures used by other companies. Net interest income and income taxes are discussed on a TEB throughout this MD&A. See Table 4 for the calculation of net interest income on a tax equivalent basis.

# Consolidated Financial Statements

## CONSOLIDATED FINANCIAL STATEMENTS



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

# Management's Responsibility for Financial Information

The consolidated financial statements of Home Capital Group Inc. were prepared by management, which is responsible for the integrity and fairness of the financial information presented. The consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles for publicly accountable enterprises, which are International Financial Reporting Standards as issued by the International Accounting Standards Board, including the accounting requirements specified by the Office of the Superintendent of Financial Institutions Canada that apply to its subsidiary Home Trust Company. The financial statements reflect amounts which must, of necessity, be based on the best estimates and judgement of management with appropriate consideration as to materiality. The financial information presented elsewhere in this report is consistent with that in the financial statements.

Management is responsible for ensuring the fairness and integrity of the financial information. It is also responsible for the implementation of the supporting accounting systems. In discharging its responsibilities, management maintains the necessary internal control system designed to provide assurance that the transactions are properly authorized, assets are safeguarded and proper accounting records are held. The controls include quality standards in hiring and training of employees, written policies, authorized limits for managers, procedure manuals, a corporate code of conduct and appropriate management information systems.

The internal control systems are further supported by a compliance function, which ensures that the Company and its employees comply with all regulatory requirements, as well as by an enterprise risk function that ensures proper risk control, related documentation and the measurement of the financial impact of risks. In addition, the internal audit function periodically assesses various aspects of the Company's operations and makes recommendations to management for, among other things, improvements to the control systems.

Every year, the Office of the Superintendent of Financial Institutions Canada makes such examinations and inquiries as deemed necessary to satisfy itself that Home Trust Company is in a sound financial position and that it complies with the provisions of the Trust and Loan Companies Act (Canada).

Ernst & Young LLP, independent auditors, appointed by the shareholders, perform an audit of the Company's consolidated financial statements and their report follows.

The internal auditors, the external auditors and the Office of the Superintendent of Financial Institutions Canada meet periodically with the Audit Committee, with management either present or absent, to discuss all aspects of their duties and matters arising therefrom.

The Board of Directors is responsible for reviewing and approving the financial statements and Management's Discussion and Analysis of results of operations and financial condition appearing in the Annual Report. It oversees the manner in which management discharges its responsibilities for the presentation and preparation of financial statements, maintenance of appropriate internal controls, risk management as well as assessment of significant transactions and related party transactions through its Audit Committee. The Audit Committee is composed solely of Directors who are not Officers or employees of the Company.

Gerald M Soloway

**Gerald M. Soloway**
*Chief Executive Officer*

**Robert Blowes, C.A., C.P.A.**
*Chief Financial Officer*

Toronto, Canada
February 14, 2012

# Independent Auditors' Report

To the Shareholders of **Home Capital Group Inc.**

We have audited the accompanying consolidated financial statements of Home Capital Group Inc., which comprise the consolidated balance sheets as at December 31, 2011 and 2010, and January 1, 2010, and the consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for the years ended December 31, 2011 and 2010, and a summary of significant accounting policies and other explanatory information.

### Management's Responsibility for the Consolidated Financial Statements

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

### Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements 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. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

### Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Home Capital Group Inc. as at December 31, 2011 and 2010, and January 1, 2010, and its financial performance and its cash flows for the years ended December 31, 2011 and 2010 in accordance with International Financial Reporting Standards.

Ernst & Young LLP

Toronto, Canada
*February 14, 2012*

*Chartered Accountants*
*Licensed Public Accountants*

# Consolidated Balance Sheets

| (thousands of Canadian dollars) | December 31 2011 | December 31 2010 (restated to IFRS) | January 1 2010 (restated to IFRS) |
|---|---|---|---|
| **ASSETS** | | | |
| **Cash Resources** (note 4(a)) | $ 665,806 | $ 846,824 | $ 930,134 |
| **Securities** (notes 4(b) and (c)) | | | |
| Held for trading | – | – | 99,938 |
| Available for sale | 391,754 | 424,168 | 494,602 |
| Pledged securities (note 6(b)) | 341,588 | 2,954 | – |
| | 733,342 | 427,122 | 594,540 |
| **Loans** (note 5) | | | |
| Residential mortgages | 6,339,883 | 4,683,527 | 4,473,255 |
| Securitized residential mortgages (note 6) | 8,243,350 | 8,116,636 | 4,126,707 |
| Non-residential mortgages | 946,222 | 838,253 | 708,425 |
| Personal and credit card loans | 560,193 | 453,339 | 342,918 |
| | 16,089,648 | 14,091,755 | 9,651,305 |
| Collective allowance for credit losses (note 5(e)) | (29,440) | (29,153) | (27,793) |
| | 16,060,208 | 14,062,602 | 9,623,512 |
| **Other** | | | |
| Income taxes receivable | – | 9,451 | 6,466 |
| Derivative assets (note 19) | 72,424 | 24,157 | 13,186 |
| Other assets (note 7) | 79,650 | 80,099 | 75,322 |
| Capital assets (note 8) | 5,372 | 4,894 | 4,863 |
| Intangible assets (note 9) | 63,917 | 47,917 | 26,811 |
| Goodwill (note 10) | 15,752 | 15,752 | 15,752 |
| | 237,115 | 182,270 | 142,400 |
| | $ 17,696,471 | $ 15,518,818 | $ 11,290,586 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | | |
| **Liabilities** | | | |
| **Deposits** (note 11) | | | |
| Deposits payable on demand | $ 62,746 | $ 50,359 | $ 38,223 |
| Deposits payable on a fixed date | 7,859,378 | 6,545,620 | 6,433,533 |
| | 7,922,124 | 6,595,979 | 6,471,756 |
| **Senior Debt** (note 12) | 153,336 | – | – |
| **Securitization liabilities** (note 6(c)) | | | |
| Mortgage-backed security liabilities | 2,417,801 | 2,826,105 | 1,191,552 |
| Canada Mortgage Bond liabilities | 6,231,274 | 5,278,473 | 2,964,904 |
| | 8,649,075 | 8,104,578 | 4,156,456 |
| **Other** | | | |
| Derivative liabilities (note 19) | 3,458 | 9,009 | 11,099 |
| Income taxes payable | 17,628 | – | – |
| Other liabilities (note 13) | 136,025 | 140,554 | 130,823 |
| Deferred tax liabilities (note 16(c)) | 40,040 | 40,113 | 16,829 |
| | 197,151 | 189,676 | 158,751 |
| | 16,921,686 | 14,890,233 | 10,786,963 |
| **Shareholders' equity** | | | |
| Capital stock (note 14) | 55,104 | 50,427 | 45,396 |
| Contributed surplus | 5,873 | 4,571 | 3,606 |
| Retained earnings | 722,999 | 567,681 | 444,416 |
| Accumulated other comprehensive (loss) income (note 15) | (9,191) | 5,906 | 10,205 |
| | 774,785 | 628,585 | 503,623 |
| | $ 17,696,471 | $ 15,518,818 | $ 11,290,586 |

**Commitments and Contingencies** (note 18)

The accompanying notes are an integral part of these consolidated financial statements.

On behalf of the Board:

Gerald M. Soloway

**Gerald M. Soloway**
*Chief Executive Officer*

**Robert A. Mitchell**
*Chair of Audit Committee*

# Consolidated Statements of Income

| For the year ended December 31 (thousands of Canadian dollars, except per share amounts) | 2011 | 2010 (restated to IFRS) |
|---|---|---|
| **Net interest income non-securitized assets** | | |
| Interest from loans | $ 401,671 | $ 353,779 |
| Dividends from securities | 18,417 | 18,204 |
| Other interest | 5,130 | 9,806 |
| | 425,218 | 381,789 |
| Interest on deposits | 191,745 | 188,370 |
| Interest on senior debt | 5,293 | – |
| Net interest income non-securitized assets | 228,180 | 193,419 |
| **Net interest income securitized loans and assets** | | |
| Interest income from securitized loans and assets | 330,491 | 251,292 |
| Interest expense on securitization liabilities | 224,719 | 180,681 |
| Net interest income securitized loans and assets | 105,772 | 70,611 |
| **Total net interest income** | 333,952 | 264,030 |
| Provision for credit losses (note 5(e)) | 7,519 | 9,431 |
| | 326,433 | 254,599 |
| **Non-interest income** | | |
| Fees and other income | 37,997 | 30,690 |
| Gain on sale of loan portfolio (note 5(g)) | – | 3,917 |
| Realized net gains and unrealized losses on securities | 4,088 | 9,740 |
| Net realized and unrealized (loss) gain on derivatives (note 19) | (7,203) | 9,821 |
| | 34,882 | 54,168 |
| | 361,315 | 308,767 |
| **Non-interest expenses** | | |
| Salaries and benefits | 52,523 | 46,739 |
| Premises | 7,776 | 6,894 |
| Other operating expenses | 44,703 | 41,843 |
| | 105,002 | 95,476 |
| **Income before income taxes** | 256,313 | 213,291 |
| Income taxes (note 16(a)) | | |
| Current | 66,270 | 35,231 |
| Deferred | (37) | 23,308 |
| | 66,233 | 58,539 |
| **NET INCOME** | $ 190,080 | $ 154,752 |
| **NET INCOME PER COMMON SHARE** (note 14(g)) | | |
| Basic | $ 5.48 | $ 4.46 |
| Diluted | $ 5.46 | $ 4.45 |
| **AVERAGE NUMBER OF COMMON SHARES OUTSTANDING** (notes 14(d) and (g)) | | |
| Basic | 34,677 | 34,697 |
| Diluted | 34,787 | 34,776 |
| Total number of outstanding common shares (note 14(b)) | 34,625 | 34,646 |
| Book value per common share | $ 22.38 | $ 18.14 |

The accompanying notes are an integral part of these consolidated financial statements.

# Consolidated Statements of Comprehensive Income

| For the year ended December 31 (thousands of Canadian dollars) | **2011** | 2010 (restated to IFRS) |
|---|---|---|
| **NET INCOME** | **$ 190,080** | $ 154,752 |
| **OTHER COMPREHENSIVE LOSS** | | |
| **Available for sale securities** | | |
| Net unrealized (losses) gains on securities available for sale | **(8,602)** | 3,224 |
| Net gains reclassified to net income | **(4,815)** | (8,509) |
| | **(13,417)** | (5,285) |
| Income tax recovery | **(3,370)** | (986) |
| | **(10,047)** | (4,299) |
| **Cash flow hedges** (note 19) | | |
| Net unrealized losses on cash flow hedges | **(7,386)** | – |
| Net losses reclassified to net income | **618** | – |
| | **(6,768)** | – |
| Income tax recovery | **(1,718)** | – |
| | **(5,050)** | – |
| Total other comprehensive loss | **(15,097)** | (4,299) |
| **COMPREHENSIVE INCOME** | **$ 174,983** | $ 150,453 |

The accompanying notes are an integral part of these consolidated financial statements.

# Consolidated Statements of Changes in Shareholders' Equity

| (thousands of Canadian dollars, except per share amounts) | Capital Stock | Contributed Surplus | Retained Earnings | Net Unrealized Gains (Losses) on Securities Available for Sale, after Tax | Net Unrealized Losses on Cash Flow Hedges, after Tax | Total Accumulated Other Comprehensive Income (Loss) | Total Shareholders' Equity |
|---|---|---|---|---|---|---|---|
| **Balance at December 31, 2010 (restated to IFRS)** | **$ 50,427** | **$ 4,571** | **$ 567,681** | **$ 5,906** | **$ –** | **$ 5,906** | **$ 628,585** |
| **Comprehensive income** | **–** | **–** | **190,080** | **(10,047)** | **(5,050)** | **(15,097)** | **174,983** |
| **Stock options settled** (note 14(b)) | **4,921** | **(1,098)** | **–** | **–** | **–** | **–** | **3,823** |
| **Amortization of fair value of employee stock options** (note 14(d)) | **–** | **2,400** | **–** | **–** | **–** | **–** | **2,400** |
| **Repurchase of shares** (note 14(c)) | **(244)** | **–** | **(7,702)** | **–** | **–** | **–** | **(7,946)** |
| **Dividends paid ($0.76 per share)** | **–** | **–** | **(27,060)** | **–** | **–** | **–** | **(27,060)** |
| **Balance at December 31, 2011** | **$ 55,104** | **$ 5,873** | **$ 722,999** | **$ (4,141)** | **$ (5,050)** | **$ (9,191)** | **$ 774,785** |
| Balance at January 1, 2010 | $ 45,396 | $ 3,606 | $ 444,416 | $ 10,205 | $ – | $ 10,205 | $ 503,623 |
| Comprehensive income | – | – | 154,752 | (4,299) | – | (4,299) | 150,453 |
| Exercise of stock appreciation rights | – | (280) | – | – | – | – | (280) |
| Stock options settled (note 14(b)) | 5,309 | (880) | – | – | – | – | 4,429 |
| Amortization of fair value of employee stock options (note 14(d)) | – | 2,125 | – | – | – | – | 2,125 |
| Repurchase of shares (note 14(c)) | (278) | – | (8,246) | – | – | – | (8,524) |
| Dividends paid ($0.66 per share) | – | – | (23,241) | – | – | – | (23,241) |
| Balance at December 31, 2010 (restated to IFRS) | $ 50,427 | $ 4,571 | $ 567,681 | $ 5,906 | $ – | $ 5,906 | $ 628,585 |

The accompanying notes are an integral part of these consolidated financial statements.

# Consolidated Statements of Cash Flows

| For the year ended December 31 (thousands of Canadian dollars) | 2011 | 2010 (restated to IFRS) |
|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| Net income for the year | $ 190,080 | $ 154,752 |
| Adjustments to determine cash flows relating to operating activities: | | |
| Deferred income taxes | (37) | 23,308 |
| Amortization of capital assets (note 8) | 3,052 | 2,881 |
| Amortization of intangible assets (note 9) | 679 | 334 |
| Amortization of net (discount) premium on securities | (49) | 2,423 |
| Amortization of securitization and senior debt transaction costs | 14,153 | 9,705 |
| Provision for credit losses (note 5(e)) | 7,519 | 9,431 |
| Change in accrued interest payable | 4,993 | 4,958 |
| Change in accrued interest receivable | (6,686) | (6,651) |
| Realized net gains and unrealized losses on securities | (4,088) | (9,740) |
| Settlement of derivatives | (7,385) | – |
| Loss (gain) on derivatives | 7,203 | (20,890) |
| Net increase in mortgages | (1,897,308) | (4,334,003) |
| Net increase in personal and credit card loans | (107,817) | (110,581) |
| Net increase in deposits | 1,326,145 | 124,223 |
| Activity in securitization liabilities | | |
| Proceeds from securitization of mortgage-backed security liabilities | 1,233,754 | 4,572,264 |
| Settlement and repayment of securitization liabilities | (753,085) | (629,934) |
| Amortization of fair value of employee stock options (note 14) | 2,400 | 2,125 |
| Changes in taxes payable and other | 23,293 | 4,352 |
| Cash flows provided by (used in) operating activities | 36,816 | (201,043) |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | |
| Repurchase of shares | (7,946) | (8,524) |
| Exercise of employee stock options and stock appreciation rights | 3,823 | 4,149 |
| Issuance of senior debt | 149,052 | – |
| Dividends paid | (26,371) | (22,906) |
| Cash flows provided by (used in) financing activities | 118,558 | (27,281) |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | |
| Activity in available for sale and held for trading securities | | |
| Purchases | (1,641,985) | (203,172) |
| Proceeds from sales | 389,978 | 214,126 |
| Proceeds from maturities | 935,824 | 158,412 |
| Purchases of capital assets (note 8) | (3,530) | (2,912) |
| Purchases of intangible assets (note 9) | (16,679) | (21,440) |
| Cash flows (used in) provided by investing activities | (336,392) | 145,014 |
| Net decrease in cash and cash equivalents during the year (note 4(a)) | (181,018) | (83,310) |
| Cash and cash equivalents at beginning of the year | 846,824 | 930,134 |
| **Cash and Cash Equivalents at End of the Year** (note 4(a)) | $ 665,806 | $ 846,824 |
| **Supplementary Disclosure of Cash Flow Information** | | |
| Dividends received | $ 17,318 | $ 16,840 |
| Interest received | 725,476 | 598,419 |
| Interest paid | 416,764 | 364,093 |
| Income taxes paid | 36,636 | 42,114 |

The accompanying notes are an integral part of these consolidated financial statements.

# Notes to the Consolidated Financial Statements

*(unless otherwise stated, all amounts are in Canadian dollars)*

## NOTE 1 CORPORATE INFORMATION

Home Capital Group Inc. (the Company) is a public holding corporation traded on the Toronto Stock Exchange. The Company is incorporated and domiciled in Canada with its registered and principal business offices located at 145 King Street West, Suite 2300, Toronto, Ontario. The Company operates primarily through its federally regulated subsidiary, Home Trust Company (Home Trust), which offers deposits, residential and non-residential mortgage lending, securitization of insured residential first mortgage products, consumer lending, *Visa* products and payment card services. Licensed to conduct business across Canada, Home Trust has branch offices in Ontario, Alberta, British Columbia, Nova Scotia and Quebec. The Company is the ultimate parent of the group.

These consolidated financial statements for the year ended December 31, 2011 were authorized for issuance by the Board of Directors of the Company on February 13, 2012. The Board of Directors has the power to amend the financial statements after their issuance only in the case of discovery of an error.

Subsequent to the end of the year and before the date these financial statements were authorized for issuance, the Board of Directors declared a quarterly cash dividend of $6.9 million or $0.20 per common share payable March 1, 2012 to shareholders of record at the close of business on February 23, 2012.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements of the Company have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) for publicly accountable enterprises which are International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

These consolidated financial statements represent the first annual financial statements of the Company prepared in accordance with IFRS. The Company adopted IFRS in accordance with International Financial Reporting Standards 1 *First-time Adoption of International Financial Reporting Standards* (IFRS 1). Further details, including the effects of the transition from the previous Canadian GAAP to IFRS, are explained in Note 26 to these consolidated financial statements.

The accounting policies were consistently applied to all periods presented unless otherwise noted. The significant accounting policies used in the preparation of these consolidated financial statements are summarized below.

### Use of Judgement and Estimates

Management has exercised judgement in the process of applying the Company's accounting policies. In particular, the Company's management has applied judgement in the application of its accounting policy with respect to derecognition of the loans and other assets used in current securitization programs. The loans and other assets are not derecognized based on management's judgement that the Company has not transferred substantially all of the risks and rewards of ownership of the loans and other assets.

The preparation of consolidated financial statements in accordance with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the consolidated balance sheet date and the reported amounts of revenue and expenses during the reporting period. Key areas where management has made estimates include allowance for credit losses, fair values and impairment of financial instruments, goodwill and intangible assets, income taxes, fair value of stock options and useful lives of capital assets and intangible assets. Actual results could differ from those estimates.

### Principles of Consolidation

The consolidated financial statements include the assets, liabilities and results of operations of the Company and all of its subsidiaries, after the elimination of intercompany transactions and balances.

Subsidiaries are entities the Company controls. The Company has control when it has the power to govern the financial and operating policies of the entity. The subsidiaries included in the consolidated financial statements are Home Trust and Payment Services Interactive Gateway Corp. (PSiGate), both of which are wholly owned.

The Company consolidates special purpose entities (SPEs) if the substance of the relationship with the Company and the SPE's risks and rewards indicate that the Company has control over the SPE. The Company is the sole beneficiary of a SPE and, accordingly, the SPE is consolidated and its assets are included in residential mortgages on the consolidated balance sheets.

### Cash Resources

For the purposes of the consolidated financial statements, cash and cash equivalents comprise balances with less than 90 days to maturity from the date of acquisition, including cash and deposits with regulated financial institutions, treasury bills and other eligible deposits. Cash and deposits are carried at amortized cost. Interest income is recognized in income using the effective interest rate method and, to the extent not received at year-end, recorded as a receivable in other assets on the consolidated balance sheets.

### Securities

Securities are classified as either held for trading or available for sale, based on management's intentions. On the trade date, all securities are recognized at their fair value, which is normally the transaction price.

Held for trading securities are financial assets purchased for resale, generally within a short period of time and primarily held for liquidity purposes. Interest earned is included in other interest income. Held for trading securities are measured at fair value, using published bid prices, as at the consolidated balance sheet date. All realized and unrealized gains and losses are reported in income under non-interest income. Transaction costs are expensed as incurred. The Company has not elected under the fair value option to designate any financial asset or liability as held for trading.

Available for sale securities are financial assets purchased for longer-term investment that may be sold in response to or in anticipation of changes in market conditions. Dividends and interest earned are included in dividends from securities or other interest income. Available for sale securities are measured at their fair value, using published bid prices, as at the consolidated balance sheet date. Unrealized gains and losses, net of related taxes, are included in accumulated other comprehensive income until the security is sold or an impairment loss is recognized, at which time the cumulative gain or loss is transferred to net income. Transaction costs are capitalized.

At the end of each reporting period, the Company conducts a review to assess whether there is any objective evidence that an available for sale security is impaired. Objective evidence of impairment results from one or more events that occur after the initial recognition of the security and which event (or events) has an impact that can be reliably estimated on the estimated future cash flows of the security. Such objective evidence includes observable data that comes to the attention of the Company such as significant financial difficulty of the issuer of the security. In the case of equity securities, objective evidence of impairment includes a significant or prolonged decline in the fair value of the security below its cost. The determination of what is significant or prolonged is based on management's judgement. Generally, management considers a significant decline to be 20% or more and a prolonged decline to be 12 months or more.

When there is objective evidence of an impairment of an available for sale security, any cumulative loss that has been recognized in other comprehensive income is reclassified from accumulated other comprehensive income to net income. The amount of the cumulative loss reclassified is the difference between the acquisition cost (net of any principal repayment, amortization and cumulative losses recognized in net income) and current fair value. In the case of debt securities, subsequent increases in fair value that can be objectively related to an event occurring after the impairment loss was recognized result in a reversal of the impairment loss through net income. Impairment losses on equity securities are not subsequently reversed through net income.

### Loans

Loans are recorded at amortized cost using the effective interest rate method. Interest income is allocated over the expected term of the loan by applying the effective interest rate to the carrying amount of the loan. The effective interest rate is the rate that exactly discounts estimated future cash receipts over the expected life of the loan. Origination revenues and costs are applied to the carrying amount of the loan.

Loans are carried net of the individual allowance for credit losses and any unearned income.

Interest income is accrued as earned with the passage of time and continues to accrue when a loan is considered impaired (with an appropriate allowance for credit loss as discussed below).

A loan is recognized as being impaired (non-performing) when the Company is no longer reasonably assured of the timely collection of the full amount of principal and interest. As a matter of practice, a loan is deemed to be impaired at the earlier of the date it has been individually provided for or when it has been in arrears for 90 days. Residential mortgages (including securitized residential mortgages) guaranteed by the Government of Canada are not considered impaired until payment is contractually 365 days past due. As securitized residential mortgages are insured, credit losses are not anticipated on this portfolio. Secured and unsecured credit card balances that have a payment that is contractually 120 days in arrears are individually provided for, and those that have a payment that is 180 days in arrears are written off. Equityline *Visa* credit card balances are measured on a basis consistent with mortgage loans.

When loans are classified as impaired, the book value of such loans is adjusted to their estimated realizable value based on the fair value of any security underlying the loan, net of any costs of realization, by totally or partially writing off the loan and/or establishing an allowance for loan losses as described below.

An impaired loan is not returned to an unimpaired status unless all principal and interest payments are up to date, and management is reasonably assured as to the recoverability of the loan.

### Allowance for Credit Losses

An allowance for credit losses is maintained at an amount which, in management's opinion, is considered adequate to absorb all credit-related losses that have occurred in the portfolio whether or not detected at the period end, including accrued interest on impaired loans. Allowances are mainly related to loans but may also apply to other assets. The allowance consists of accumulated individual and collective allowances, each of which is reviewed at least quarterly. The collective allowance is deducted from the loans on the consolidated balance sheets.

#### *Individual Allowances*

Individual allowances are determined on an item-by-item basis and reflect the associated estimate of credit loss. In the case of loans and Equityline *Visa* credit cards, the individual allowances are the amounts required to reduce the carrying value of an impaired asset, including accrued interest, to its estimated realizable amount. The fair value of the underlying security is used to estimate the realizable amount of the receivable. The allowance is the difference between the receivable's carrying value, including accrued interest, and its estimated realizable amount. For secured and unsecured credit card receivables, individual provisions are provided for arrears over 120 days.

#### *Collective Allowances*

Collective allowances are established to absorb credit losses on the aggregate exposures in each of the Company's loan portfolios for which losses have been incurred but not yet individually identified. The collective allowance is based upon statistical analysis of past performance, level of allowance already in place and management's judgement. The collective allowance, based on the historical loss experience adjusted to reflect changes in the portfolios and credit policies, is applied to each pool of loans with common risk characteristics. This estimate includes consideration of economic and business conditions.

The amount of the provision for credit losses that is charged to the consolidated statements of income is the amount that is required to establish a balance in the allowance for credit losses account that the Company's management considers adequate to absorb all credit-related losses in its portfolio of balance sheet items after charging amounts written off during the year, net of any recoveries, to the allowance for credit losses account.

### Securitized Loans and Securitization Liabilities

The Company periodically transfers pools of mortgages to SPEs or trusts that, in turn, issue securities to investors. Mortgage loan securitization is part of the Company's liquidity funding strategy. The Company only transfers assets to Canada Mortgage and Housing Corporation (CMHC) sponsored entities.

Transfers of pools of mortgages under the current programs do not result in derecognition of the mortgages from the Company's consolidated balance sheets. As such, these transactions result in the recognition of securitization liabilities when cash is received from the securitization entities. Such mortgages are reclassified to securitized residential mortgages on the consolidated balance sheets and continue to be accounted for as loans, as described above.

The securitization liabilities are recorded at amortized cost using the effective interest rate method. Interest expense is allocated over the expected term of the borrowing by applying the effective interest rate to the carrying amount of the liability. The effective interest rate is the rate that exactly discounts estimated future cash outflows over the expected life of the liability. Transaction costs and premiums or discounts are applied to the carrying amount of the liability.

### Derivatives Held for Risk Management Purposes

The Company utilizes derivatives to manage interest rate risk. Derivatives are carried at fair value and are reported as assets if they have a positive fair value and as liabilities if they have a negative fair value. The Company applies hedge accounting to derivatives that meet the criteria for hedge accounting in IAS 39 *Financial Instruments*: *Recognition and Measurement* (IAS 39). The Company utilizes two types of hedge relationships for accounting purposes, fair value hedges and cash flow hedges. If derivative instruments do not meet the criteria for hedge accounting, the changes in fair value of such derivatives are recognized in net income.

In order to qualify for hedge accounting, a hedge relationship must be designated and formally documented in accordance with IAS 39. The Company's documentation, in accordance with the requirements, includes the specific risk management objective and strategy being applied, the specific financial asset or liability or cash flow being hedged and how hedge effectiveness is assessed. To qualify for hedge accounting, the Company has decided that there must be a correlation of between 80% and 125% in the changes in fair values or cash flows between the hedged and hedging items.

Hedge effectiveness is assessed at the inception of the hedge and on an ongoing basis, which is at least quarterly. Hedge ineffectiveness occurs when the changes in the fair value of the hedging item (derivative) differ significantly from the fair value changes in the hedged risk in the hedged item, or when the cumulative change in the fair value of the hedging item exceeds the cumulative change in the fair value of the future expected cash flows of the hedged item. Hedge ineffectiveness is recognized immediately in income.

### Fair Value Hedges

Fair value hedges are designated as part of the Company's interest rate risk management strategies. These strategies generally use interest rate swap derivatives to hedge changes in the fair value of fixed rate liabilities (securitization liabilities) attributable to interest rate risk. Changes in fair value of the hedged fixed rate liabilities attributable to the interest rate risk being hedged are recorded as part of the carrying value of the hedged item and are recognized in net interest income. Changes in fair value of the hedging item (interest rate swap) are also recognized in net interest income. As such, any hedge ineffectiveness resulting from differences in the fair value changes is also recognized in non-interest income.

If the hedging instrument expires, is settled or sold, or if the hedge no longer meets the criteria for hedge accounting under IAS 39, the hedge relationship is terminated and the basis adjustment on the fixed rate liability is then amortized over the remaining term of the fixed rate liability. If the hedged item is settled, the unamortized basis adjustment is recognized in income immediately.

### Cash Flow Hedges

Cash flow hedges are designated as part of the Company's interest rate risk management strategies. These strategies generally use bond forwards or interest rate swaps to hedge changes in future cash flows attributable to interest rate fluctuations arising on highly probable forecasted issuances of fixed rate secured borrowings.

The effective portion of the change in fair value of the derivative instrument is recognized in other comprehensive income (OCI) until the forecasted cash flows being hedged are recognized in income in future accounting periods. When the forecasted cash flows are recognized in income, an appropriate amount of the fair values changes of the derivative instrument in accumulated other comprehensive income (AOCI) is reclassified into income. Any hedge ineffectiveness is immediately recognized in non-interest income. If the forecasted issuance of fixed rate debt is no longer expected to occur, the related cumulative gain (loss) in AOCI is immediately recognized in income.

### Capital Assets

Capital assets, which comprise office furniture and equipment, computer equipment and software and leasehold improvements, are recorded at cost and amortized over their estimated useful lives on a straight-line basis. The ranges of useful lives for each asset type are as follows:

| | |
|---|---|
| Office furniture and equipment | 5 to 10 years |
| Computer equipment and software | 3 to 7 years |

Leasehold improvements are amortized on a straight-line basis over the remaining term of the leases.

The Company assesses, at each reporting period date, whether there is an indication that a capital asset may be impaired. If any indication of impairment exists, the Company performs an impairment test to determine whether an impairment loss is required to be recognized. The impairment tests are performed in accordance with the steps discussed in the accounting policy note below entitled "Impairment of Non-financial Assets Other Than Goodwill."

### Goodwill

Goodwill is initially measured as the excess of the price paid for the acquisition of a consolidated entity over the fair value of the net identifiable tangible and intangible assets acquired. Goodwill is allocated to the cash-generating units (CGUs) or groups of CGUs that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units. A CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. Each unit to which the goodwill has been allocated represents the lowest level within the Company at which the goodwill is monitored for internal management purposes and is not larger than an operating segment.

Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is evaluated for impairment annually or more often if events or circumstances indicate there may be impairment. Impairment is determined for goodwill by assessing whether the carrying amount of a CGU, including the allocated goodwill, exceeds its recoverable amount. The recoverable amount is determined as the greater of the estimated fair value less costs to sell or the value in use. Impairment losses recognized in respect of a CGU are first allocated to the carrying amount of goodwill and any excess is allocated pro rata to the carrying amount of other assets in the CGU, on the basis of the carrying amount of each asset in the unit. Any goodwill impairment is charged to income in the period in which the impairment is identified. Impairment losses on goodwill are not subsequently reversed.

### Intangible Assets

An intangible asset is recognized only when its cost can be measured reliably and it is probable that the expected future economic benefits that are attributable to the asset will flow to the Company. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and any accumulated impairment losses.

The Company's intangible assets comprise software development costs. The Company's software development costs are considered to have finite useful lives and are amortized on a straight-line basis over their useful lives, generally not exceeding 10 years. The amortization period and the amortization method are reviewed at least at each financial year-end. Changes in the expected useful life are accounted for by changing the amortization period, as appropriate, and treated as changes in accounting estimates. Amortization expense is included in other operating expenses in the consolidated statement of income.

The Company capitalized eligible development costs related to the development of its new core banking system. Amortization of these costs over the appropriate useful life commenced when the development of the software module was substantially completed and the software became available for use in the manner intended by management. Eligible costs include external direct costs for materials and services, as well as payroll and payroll-related costs for employees directly associated with the project. Overhead costs, costs incurred during the research phase, costs to train staff to operate the asset and costs incurred after the software was substantially completed and available for use are expensed as incurred. The Company continues to capitalize eligible development costs related to additional software projects and will commence amortization of these costs when development of the asset is substantially complete and the asset becomes available for use in the manner intended by management.

The Company assesses, at each reporting period date, whether there is an indication that an intangible asset may be impaired. If any indication of impairment exists, the Company performs an impairment test to determine whether an impairment loss is required to be recognized. In relation to development costs for software that is not yet available for use, the Company performs an impairment test on an annual basis and also when indications of impairment exist. Such annual impairment tests will continue until the software is available for use. The impairment tests are performed in accordance with the steps discussed in the accounting policy note below entitled "Impairment of Non-financial Assets Other Than Goodwill."

### Impairment of Non-financial Assets Other Than Goodwill

The Company assesses at each reporting date whether there is an indication that an asset may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Company estimates the asset's recoverable amount. If it is not possible to determine the recoverable amount of the individual asset, the Company determines the recoverable amount of the CGU to which the asset belongs. The recoverable amount of an asset or a CGU is the higher of its fair value less costs to sell and its value in use, where value in use is the present value of the future cash flows expected to be derived from the asset or the CGU. Where the carrying amount of the asset or the CGU exceeds its recoverable amount, the asset is considered impaired and written down to its recoverable amount. The Company evaluates impairment losses for potential reversals when events or changes in circumstances warrant such consideration.

### Deposits

Deposits are financial liabilities that are measured at cost using the effective interest rate method. Deposit origination costs are included in deposits on the consolidated balance sheets as incurred and amortized to interest expense over the term of the deposit.

### Senior Debt

Senior debt is carried at amortized cost, including the principal amount received on issue, plus accrued interest and costs incurred on issue, less repayments of principal and interest and amortization of issue costs and any premium or discount to the face amount of the debt. Issue costs and premium or discount are amortized to income using the effective interest rate method.

### Income Taxes

The Company follows the asset and liability method of accounting for income taxes, whereby deferred tax assets and liabilities are recognized for the expected future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted or substantively enacted tax rates applicable to taxable income in the period in which those temporary differences are expected to be recovered or settled. Deferred tax assets are only recognized for deductible temporary differences, carry-forward of unused tax credits and losses to the extent that it is probable that taxable profit will be available and the carry-forward of unused tax credits and losses can be utilized.

### Fee Income

Fee income is accrued and recognized as income as the associated services are rendered.

### Stock-based Compensation Plans

The Company has two stock-based compensation plans, which are described in Note 14.

The Company's Employee Stock Option Plan provides for the granting of stock options to certain employees and Directors of the Company. In some cases, stock appreciation rights are also granted in tandem with the stock option, providing the Company with, at its sole discretion, the alternative of settling the award in cash at an amount equal to the excess of the market price of the shares to which the option relates over the exercise price of the option. The Company accounts for stock options, including those with tandem stock appreciation rights, as equity-settled transactions where the fair value of options granted is charged to salary expense over the option vesting period, with the offsetting amount recognized in contributed surplus. For awards with graded vesting, the fair value of each tranche is recognized separately over its respective vesting period. For each reporting period, the Company reassesses its estimates of the number of awards that are expected to vest and recognizes the impact of any revision in the consolidated statements of income with a corresponding adjustment to equity. The fair value of the options granted is determined using a Black-Scholes option pricing model using management's best estimates.

The Company offers a deferred share unit plan (DSU) that is only open to non-employee Directors of the Company who annually elect to accept remuneration in the form of cash, cash and DSUs, or DSUs. The Company accounts for the DSUs as cash-settled transactions. Under the plan, the obligations for the DSUs are accrued quarterly based on the Directors' remuneration for the quarter. The obligations are periodically adjusted for fluctuations in the market price of the Company's common shares and allow for dividend equivalents. Changes in obligations under the plan are recorded as salaries and benefits in the consolidated statements of income with a corresponding increase in other liabilities on the consolidated balance sheets.

### Employee Benefit Plans

Under both the Employee Share Purchase Plan and the Employee Retirement Savings Plan, the Company's contribution is expensed when paid (see Note 17).

### Translation of Foreign Currencies

Assets and liabilities denominated in foreign currencies are translated into Canadian dollars at rates prevailing at the consolidated balance sheet date. Revenues and expenses denominated in foreign currencies are translated at the average exchange rates prevailing during the period. Realized and unrealized gains and losses on foreign currency transactions are included in fees and other income in the consolidated statements of income.

## NOTE 3 FUTURE CHANGES IN ACCOUNTING POLICIES

The following accounting pronouncements issued by the IASB were not effective as at December 31, 2011 and therefore have not been applied in preparing these consolidated financial statements.

### IAS 1 *Presentation of Financial Statements*

In June 2011, the IASB issued amendments to IAS 1 *Presentation of Financial Statements* (IAS 1), which are effective for annual periods beginning on or after July 1, 2012, with earlier application permitted. The amendments may result in changes in the way OCI is presented in the consolidated statement of income. Management is currently evaluating the potential impact that the adoption of IFRS 1 will have on the presentation of Company's consolidated financial statements.

### IFRS 7 *Financial Instruments: Disclosures*

In October 2010, the IASB issued amendments to IFRS 7 regarding *Disclosures – Transfers of Financial Assets*, which are effective for annual periods beginning on or after July 1, 2011, with earlier application permitted. The amendments comprise additional disclosures on financial asset transfer transactions. These amendments will not have an impact on the results of operations or financial position of the Company as they are disclosure requirements only.

### IFRS 9 *Financial Instruments*

In November 2009, the IASB issued, and subsequently revised in October 2010, IFRS 9 *Financial Instruments* (IFRS 9) as a first phase in its ongoing project to replace IAS 39. IFRS 9, which is to be applied retrospectively, is effective for annual periods beginning on or after January 1, 2015, with earlier application permitted. IFRS 9 provides new requirements as to how an entity should classify and measure financial assets and liabilities that are in the scope of IAS 39. The standard requires all financial assets to be classified on the basis of the entity's business model for managing such financial assets and the contractual cash flow characteristics of the financial assets.

### IFRS 10 *Consolidated Financial Statements*

In May 2011, the IASB issued IFRS 10 *Consolidated Financial Statements* (IFRS 10) which is effective for annual periods beginning on or after January 1, 2013, with earlier adoption permitted. IFRS 10 will replace portions of IAS 27 *Consolidated and Separate Financial Statements* (IAS 27) and interpretation SIC-12 *Consolidation – Special Purpose Entities*. Under IFRS 10, consolidated financial statements will include all controlled entities under a single control model. Management is currently evaluating the potential impact that the adoption of IFRS 10 will have on the Company's consolidated financial statements.

### IFRS 12 *Disclosure of Interests in Other Entities*

In May 2011, the IASB issued IFRS 12 *Disclosure of Interests in Other Entities* (IFRS 12) which is effective for annual periods beginning on or after January 1, 2013, with earlier adoption permitted. IFRS 12 provides disclosure requirements about subsidiaries, joint ventures and associates, as well as unconsolidated structured entities and replaces existing disclosure requirements. The requirements of IFRS 12 will not have an impact on the results of operations or financial position of the Company as they are disclosure requirements only.

### IFRS 13 *Fair Value Measurement*

In May 2011, the IASB issued IFRS 13 *Fair Value Measurement* (IFRS 13) which is effective for annual periods beginning on or after January 1, 2013, with earlier adoption permitted. IFRS 13 establishes a single source of guidance for fair value measurements when fair value is required or permitted by IFRS and provides for enhanced disclosures when fair value is applied. Management is currently evaluating the potential impact that the adoption of IFRS 13 will have on the Company's consolidated financial statements.

### IAS 27 *Separate Financial Statements*

In May 2011, the IASB reissued IAS 27 which is effective for annual periods beginning on or after January 1, 2013, with earlier adoption permitted. As the consolidation guidance will now be included in IFRS 10, IAS 27 will only prescribe the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when the entity prepares separate financial statements. Management is currently evaluating the potential impact that the adoption of the reissued IAS 27 will have on the financial statements of the Company's subsidiaries.

## NOTE 4 CASH RESOURCES AND SECURITIES

### (a) Cash Resources

| (thousands of Canadian dollars) | December 31 2011 | December 31 2010 | January 1 2010 |
|---|---|---|---|
| Deposits with regulated financial institutions | $ 563,909 | $ 344,004 | $ 866,069 |
| Treasury bills guaranteed by government | 144 | 406,938 | – |
| Cash and cash equivalents | 564,053 | 750,942 | 866,069 |
| Restricted cash – Canada Mortgage Bond program | 70,000 | 70,000 | 46,100 |
| Restricted cash – interest rate swaps | 26,176 | 22,255 | 17,965 |
| Restricted cash – National Energy Corporation | 5,577 | 3,627 | – |
| | $ 665,806 | $ 846,824 | $ 930,134 |

*Restricted cash – Canada Mortgage Bond program* represents deposits held as collateral by CMHC in connection with the Company's securitization activities. To participate in the National Housing Authority (NHA) mortgage-backed security (MBS) programs, the Company is required to maintain an amount of cash in a trust account to cover deposits of unscheduled principal prepayments (UPP). The amount represents a percentage of UPP, which is based on the Company's average monthly UPP rate for the last year and calculated on the basis of the end of year principal balance. The Company is allowed to invest the above amount in eligible securities. The funds must be invested on behalf of the Principal & Interest Custodial/Trust Account. Currently, these funds are deposits held by a Canadian Schedule A Bank.

*Restricted cash – interest rate swaps* are deposits held by swap counterparties as collateral for the Company's interest rate swap transactions. The Company is required to provide collateral against its interest rate swap transactions as part of the agreements with the counterparties. The terms and conditions for these collaterals are governed by International Swaps Dealers Associations (ISDA) agreements.

*Restricted cash – National Energy Corporation* are reserve accounts held in trust for the water heater financing program.

### (b) Securities at Fair Value by Type and Remaining Term to Maturity

| | | | | | December 31 2011 | December 31 2010 | January 1 2010 |
|---|---|---|---|---|---|---|---|
| (thousands of Canadian dollars) | Within 1 Year | 1 to 3 Years | 3 to 5 Years | Over 5 Years | Total Fair Value | Total Fair Value | Total Fair Value |
| **Held for trading** | | | | | | | |
| Securities issued or guaranteed by Canada | $ – | $ – | $ – | $ – | $ – | $ – | $ 99,938 |
| **Available for sale** | | | | | | | |
| Securities issued or guaranteed by | | | | | | | |
| Canada | 41 | 5,155 | – | – | 5,196 | 4,981 | – |
| Corporations | – | 8,060 | – | – | 8,060 | 96,652 | 194,085 |
| Equity securities | | | | | | | |
| Common | 8,851 | – | – | – | 8,851 | 7,362 | 6,805 |
| Fixed rate preferred | 56,703 | 151,682 | 117,910 | 42,178 | 368,473 | 309,331 | 287,967 |
| Income trusts | – | – | – | – | – | 4,727 | 4,800 |
| Mutual funds | 1,174 | – | – | – | 1,174 | 1,115 | 945 |
| **Pledged securities** | | | | | | | |
| Securities issued or guaranteed by Canada | 320,535 | 21,053 | – | – | 341,588 | 2,954 | – |
| | $ 387,304 | $ 185,950 | $ 117,910 | $ 42,178 | $ 733,342 | $ 427,122 | $ 594,540 |

During 2011, the Company had no activity in held for trading securities. In 2010, the Company recognized $0.2 million in net income related to held for trading securities.

### (c) Unrealized Gains and Losses on Available for Sale Securities

| December 31 2011 (thousands of Canadian dollars, except %) | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Total Fair Value | Weighted-average Yield |
|---|---|---|---|---|---|
| Securities issued or guaranteed by | | | | | |
| Canada | $ 5,069 | $ 127 | $ – | $ 5,196 | 2.5% |
| Corporations | 8,060 | – | – | 8,060 | 2.0% |
| Equity securities | | | | | |
| Common | 7,536 | 1,683 | (368) | 8,851 | 7.4% |
| Fixed rate preferred | 375,853 | 2,591 | (9,971) | 368,473 | 5.0% |
| Mutual funds | 1,000 | 174 | – | 1,174 | – |
| | $ 397,518 | $ 4,575 | $ (10,339) | $ 391,754 | |

| December 31 2010 (thousands of Canadian dollars, except %) | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Total Fair Value | Weighted-average Yield |
|---|---|---|---|---|---|
| Securities issued or guaranteed by | | | | | |
| Canada | $ 4,981 | $ – | $ – | $ 4,981 | 1.9% |
| Corporations | 96,522 | 130 | – | 96,652 | 1.8% |
| Equity securities | | | | | |
| Common | 5,778 | 1,761 | (177) | 7,362 | 2.1% |
| Fixed rate preferred | 303,049 | 7,631 | (1,349) | 309,331 | 5.0% |
| Income trusts | 5,185 | – | (458) | 4,727 | 5.1% |
| Mutual funds | 1,000 | 115 | – | 1,115 | – |
| | $ 416,515 | $ 9,637 | $ (1,984) | $ 424,168 | |

| January 1 2010 (thousands of Canadian dollars, except %) | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Total Fair Value | Weighted-average Yield |
|---|---|---|---|---|---|
| Securities issued or guaranteed by | | | | | |
| Corporations | $ 194,120 | $ – | $ (35) | $ 194,085 | 1.3% |
| Equity securities | | | | | |
| Common | 4,288 | 2,527 | (10) | 6,805 | 2.5% |
| Fixed rate preferred | 279,862 | 13,038 | (4,933) | 287,967 | 5.4% |
| Income trusts | 2,394 | 2,406 | – | 4,800 | 5.0% |
| Mutual funds | 1,000 | – | (55) | 945 | – |
| | $ 481,664 | $ 17,971 | $ (5,033) | $ 494,602 | |

Net unrealized gains and losses are included in AOCI except for impairment losses which are transferred to net income. AOCI is disclosed in Note 15.

The unrealized losses included above represent differences between the cost of a security and its current fair value. The Company regularly monitors its investments and market conditions for indications of impairment.

For the year ended December 31, 2011, the Company recognized $3.0 million (2010 – $0.4 million) of impairment losses on available for sale securities. These losses were transferred into net income. These unrealized losses are not included in the above table.

## NOTE 5 LOANS

**(a) Loans by Geographic Region and Type (net of individual allowances for credit losses)**

As at December 31 **2011**

| (thousands of Canadian dollars, except %) | Residential Mortgages | Securitized Residential Mortgages | Non-residential Mortgages | Personal and Credit Card Loans | Total | Percentage of Portfolio |
|---|---|---|---|---|---|---|
| British Columbia | **$ 330,489** | **$ 876,151** | **$ 5,441** | **$ 12,300** | **$ 1,224,381** | **7.6%** |
| Alberta | **323,797** | **700,006** | **25,851** | **31,785** | **1,081,439** | **6.7%** |
| Ontario | **5,346,584** | **5,564,549** | **842,173** | **508,558** | **12,261,864** | **76.2%** |
| Quebec | **229,526** | **695,730** | **47,829** | **1,928** | **975,013** | **6.1%** |
| Atlantic provinces | **99,702** | **210,355** | **24,928** | **4,413** | **339,398** | **2.1%** |
| Other | **9,785** | **196,559** | **–** | **1,209** | **207,553** | **1.3%** |
| | **$ 6,339,883** | **$ 8,243,350** | **$ 946,222** | **$ 560,193** | **$ 16,089,648** | **100.0%** |
| As a % of portfolio | **39.4%** | **51.2%** | **5.9%** | **3.5%** | **100.0%** | |

As at December 31 2010

| (thousands of Canadian dollars, except %) | Residential Mortgages | Securitized Residential Mortgages | Non-residential Mortgages | Personal and Credit Card Loans | Total | Percentage of Portfolio |
|---|---|---|---|---|---|---|
| British Columbia | $ 313,225 | $ 897,890 | $ 9,580 | $ 15,921 | $ 1,236,616 | 8.8% |
| Alberta | 302,113 | 719,726 | 31,813 | 39,090 | 1,092,742 | 7.8% |
| Ontario | 3,686,264 | 5,411,314 | 736,310 | 391,976 | 10,225,864 | 72.5% |
| Quebec | 157,098 | 665,942 | 34,710 | 1,482 | 859,232 | 6.1% |
| Atlantic provinces | 128,328 | 224,695 | 25,840 | 3,661 | 382,524 | 2.7% |
| Other | 96,499 | 197,069 | – | 1,209 | 294,777 | 2.1% |
| | $ 4,683,527 | $ 8,116,636 | $ 838,253 | $ 453,339 | $ 14,091,755 | 100.0% |
| As a % of portfolio | 33.3% | 57.6% | 5.9% | 3.2% | 100.0% | |

As at January 1 2010

| (thousands of Canadian dollars, except %) | Residential Mortgages | Securitized Residential Mortgages | Non-residential Mortgages | Personal and Credit Card Loans | Total | Percentage of Portfolio |
|---|---|---|---|---|---|---|
| British Columbia | $ 480,004 | $ 494,867 | $ 9,270 | $ 22,617 | $ 1,006,758 | 10.4% |
| Alberta | 368,201 | 494,736 | 76,424 | 54,209 | 993,570 | 10.3% |
| Ontario | 3,326,976 | 2,414,112 | 570,339 | 258,952 | 6,570,379 | 68.1% |
| Quebec | 133,798 | 453,652 | 31,660 | 1,594 | 620,704 | 6.4% |
| Atlantic provinces | 93,139 | 122,826 | 11,399 | 4,095 | 231,459 | 2.4% |
| Other | 71,137 | 146,514 | 9,333 | 1,451 | 228,435 | 2.4% |
| | $ 4,473,255 | $ 4,126,707 | $ 708,425 | $ 342,918 | $ 9,651,305 | 100.0% |
| As a % of portfolio | 46.3% | 42.8% | 7.3% | 3.6% | 100.0% | |

### (b) Past Due Loans That Are Not Impaired

A loan is recognized as being impaired (non-performing) when the Company is no longer reasonably assured of the timely collection of the full amount of principal and interest. As a matter of practice, a loan is deemed to be impaired at the earlier of the date it has been individually provided for or when it has been in arrears for 90 days. Residential mortgages (including securitized residential mortgages) guaranteed by the Government of Canada are not considered impaired until payment is contractually 365 days past due. As securitized residential mortgages are insured, credit losses are not anticipated on this portfolio. Secured and unsecured credit card balances that have a payment that is contractually 120 days in arrears are individually provided for and those that have a payment that is contractually 180 days in arrears are written off. Equityline *Visa* credit card balances are measured on a basis consistent with mortgage loans.

| As at December 31 | | | | | **2011** |
|---|---|---|---|---|---|
| (thousands of Canadian dollars) | **Residential Mortgages** | **Securitized Residential Mortgages** | **Non-residential Mortgages** | **Personal and Credit Card Loans** | **Total** |
| 1–30 days | **$ 208,340** | **$ 72,359** | **$ 6,237** | **$ 4,809** | **$ 291,745** |
| 31–60 days | **43,809** | **10,169** | **264** | **1,018** | **55,260** |
| 61–90 days | **11,707** | **324** | **284** | **1,343** | **13,658** |
| Over 90 days | **15,333**[1] | **10,957**[1] | **–** | **1,649** | **27,939** |
| | **$ 279,189** | **$ 93,809** | **$ 6,785** | **$ 8,819** | **$ 388,602** |

| As at December 31 | | | | | 2010 |
|---|---|---|---|---|---|
| (thousands of Canadian dollars) | Residential Mortgages | Securitized Residential Mortgages | Non-residential Mortgages | Personal and Credit Card Loans | Total |
| 1–30 days | $ 108,842 | $ 39,981 | $ 4,671 | $ 4,706 | $ 158,200 |
| 31–60 days | 26,027 | 5,836 | 1,022 | 1,922 | 34,807 |
| 61–90 days | 6,038 | 3,055 | – | 1,857 | 10,950 |
| Over 90 days | 7,080[1] | 10,909[1] | – | 1,384 | 19,373 |
| | $ 147,987 | $ 59,781 | $ 5,693 | $ 9,869 | $ 223,330 |

| As at January 1 | | | | | 2010 |
|---|---|---|---|---|---|
| (thousands of Canadian dollars) | Residential Mortgages | Securitized Residential Mortgages | Non-residential Mortgages | Personal and Credit Card Loans | Total |
| 1–30 days | $ 134,925 | $ 50,396 | $ 4,058 | $ 5,204 | $ 194,583 |
| 31–60 days | 36,149 | 10,450 | 1,910 | 1,428 | 49,937 |
| 61–90 days | 3,080 | 3,386 | – | 2,162 | 8,628 |
| Over 90 days | 8,911[1] | 24,005[1] | – | 749 | 33,665 |
| | $ 183,065 | $ 88,237 | $ 5,968 | $ 9,543 | $ 286,813 |

[1] Insured residential mortgages are considered impaired when they are 365 days past due.

### (c) Impaired Loans and Individual Allowances for Credit Losses

Residential mortgages guaranteed by the Government of Canada are not considered impaired until payment is contractually 365 days past due. As securitized residential mortgages are all fully insured, credit losses are not anticipated.

| As at December 31 | | | | | | | | | | **2011** |
|---|---|---|---|---|---|---|---|---|---|---|
| (thousands of Canadian dollars) | | **Residential Mortgages** | | **Securitized Residential Mortgages** | | **Non-residential Mortgages** | | **Personal and Credit Card Loans** | | **Total** |
| Gross amount of impaired loans | **$** | **36,845** | **$** | **–** | **$** | **822** | **$** | **4,144** | **$** | **41,811** |
| Individual allowances on principal | | **(742)** | | **–** | | **(78)** | | **(694)** | | **(1,514)** |
| Net | **$** | **36,103** | **$** | **–** | **$** | **744** | **$** | **3,450** | **$** | **40,297** |

| As at December 31 | | | | | | | | | | 2010 |
|---|---|---|---|---|---|---|---|---|---|---|
| (thousands of Canadian dollars) | | Residential Mortgages | | Securitized Residential Mortgages | | Non-residential Mortgages | | Personal and Credit Card Loans | | Total |
| Gross amount of impaired loans | $ | 29,586 | $ | – | $ | 2,295 | $ | 7,241 | $ | 39,122 |
| Individual allowances on principal | | (1,757) | | – | | – | | (3,140) | | (4,897) |
| Net | $ | 27,829 | $ | – | $ | 2,295 | $ | 4,101 | $ | 34,225 |

| As at January 1 | | | | | | | | | | 2010 |
|---|---|---|---|---|---|---|---|---|---|---|
| (thousands of Canadian dollars) | | Residential Mortgages | | Securitized Residential Mortgages | | Non-residential Mortgages | | Personal and Credit Card Loans | | Total |
| Gross amount of impaired loans | $ | 41,621 | $ | – | $ | 2,417 | $ | 4,847 | $ | 48,885 |
| Individual allowances on principal | | (1,483) | | – | | (135) | | (961) | | (2,579) |
| Net | $ | 40,138 | $ | – | $ | 2,282 | $ | 3,886 | $ | 46,306 |

Included in the gross amount of impaired loans are foreclosed loans with an estimated realizable value of $3.7 million (2010 – $1.6 million).

### (d) Collateral

The fair value of collateral held against mortgages is based on appraisals at the time a loan is originated. Appraisals are only updated should circumstances warrant it or if a mortgage becomes impaired. At December 31, 2011, the total appraised value of the collateral held for mortgages past due that are not impaired, as determined when the mortgages were originated, was $556.9 million (2010 – $465.4 million). For impaired mortgages, the total appraised value of collateral at December 31, 2011 was $132.0 million (2010 – $49.3 million).

### (e) Allowance for Credit Losses

**2011**

| (thousands of Canadian dollars) | **Residential Mortgages** | **Non-residential Mortgages** | **Personal and Credit Card Loans** | **Total** |
|---|---|---|---|---|
| Individual allowances | | | | |
| Allowance on loan principal | | | | |
| Balance at the beginning of the year | **$ 1,757** | **$ –** | **$ 3,140** | **$ 4,897** |
| Provision for credit losses | **6,248** | **78** | **964** | **7,290** |
| Write-offs | **(7,754)** | **–** | **(3,574)** | **(11,328)** |
| Recoveries | **491** | **–** | **164** | **655** |
| | **742** | **78** | **694** | **1,514** |
| Allowance on accrued interest receivable | | | | |
| Balance at the beginning of the year | **403** | **–** | **–** | **403** |
| Provision for credit losses | **(58)** | **–** | **–** | **(58)** |
| | **345** | **–** | **–** | **345** |
| Total individual allowance | **1,087** | **78** | **694** | **1,859** |
| Collective allowance | | | | |
| Balance at the beginning of the year | **16,299** | **9,357** | **3,497** | **29,153** |
| Provision for credit losses | **–** | **(57)** | **344** | **287** |
| | **16,299** | **9,300** | **3,841** | **29,440** |
| Total allowance | **$ 17,386** | **$ 9,378** | **$ 4,535** | **$ 31,299** |
| Total provision | **$ 6,190** | **$ 21** | **$ 1,308** | **$ 7,519** |

2010

| (thousands of Canadian dollars) | Residential Mortgages | Non-residential Mortgages | Personal and Credit Card Loans | Total |
|---|---|---|---|---|
| Individual allowances | | | | |
| Allowance on loan principal | | | | |
| Balance at the beginning of the year | $ 1,483 | $ 135 | $ 961 | $ 2,579 |
| Provision for credit losses | 4,109 | (135) | 4,077 | 8,051 |
| Write-offs | (6,345) | – | (2,177) | (8,522) |
| Recoveries | 2,510 | – | 279 | 2,789 |
| | 1,757 | – | 3,140 | 4,897 |
| Allowance on accrued interest receivable | | | | |
| Balance at the beginning of the year | 383 | – | – | 383 |
| Provision for credit losses | 20 | – | – | 20 |
| | 403 | – | – | 403 |
| Total individual allowance | 2,160 | – | 3,140 | 5,300 |
| Collective allowance | | | | |
| Balance at the beginning of the year | 19,948 | 4,398 | 3,447 | 27,793 |
| Provision for credit losses | (3,649) | 4,959 | 50 | 1,360 |
| | 16,299 | 9,357 | 3,497 | 29,153 |
| Total allowance | $ 18,459 | $ 9,357 | $ 6,637 | $ 34,453 |
| Total provision | $ 480 | $ 4,824 | $ 4,127 | $ 9,431 |

There were no provisions, allowances or net write-offs on securitized residential mortgages, which are insured.

### (f) Loan Maturities

| (thousands of Canadian dollars) | Within 1 Year | 1 to 3 Years | 3 to 5 Years | Over 5 Years | December 31 2011 Total Book Value | December 31 2010 Total Book Value | January 1 2010 Total Book Value |
|---|---|---|---|---|---|---|---|
| Residential mortgages | **$ 3,575,979** | **$ 2,217,349** | **$ 509,185** | **$ 37,370** | **$ 6,339,883** | $ 4,683,527 | $ 4,473,255 |
| Securitized residential mortgages | **812,990** | **3,195,083** | **3,534,124** | **701,153** | **8,243,350** | 8,116,636 | 4,126,707 |
| Non-residential mortgages | **472,643** | **352,282** | **83,696** | **37,601** | **946,222** | 838,253 | 708,425 |
| Personal and credit card loans | **398,447** | **11,926** | **92,965** | **56,855** | **560,193** | 453,339 | 342,918 |
| | **5,260,059** | **5,776,640** | **4,219,970** | **832,979** | **16,089,648** | 14,091,755 | 9,651,305 |
| Collective allowance for credit losses | **–** | **–** | **–** | **–** | **(29,440)** | (29,153) | (27,793) |
| | **$ 5,260,059** | **$ 5,776,640** | **$ 4,219,970** | **$ 832,979** | **$ 16,060,208** | $ 14,062,602 | $ 9,623,512 |

### (g) Sale of Loan Portfolio

During 2010, the Company recognized a $3.9 million gain on sale of a portfolio of individual water heater loans totalling $19.5 million.

## NOTE 6 SECURITIZATION ACTIVITY

### (a) Securitized Assets

The Company's wholly owned subsidiary, Home Trust, securitizes insured residential mortgage loans by participating in the NHA MBS program. Through the program the Company issues securities backed by residential mortgage loans that are insured against borrowers' default. Once the mortgage loans are securitized, the Company assigns underlying mortgages and/or related securities to CMHC. As an issuer of the MBS, Home Trust is responsible for advancing all scheduled principal and interest payments to CMHC, irrespective of whether or not the amounts have been collected on the underlying transferred mortgages. Amounts advanced but not recovered will ultimately be recovered from the insurer.

The securitization activity includes the Company's participation in the Canada Mortgage Bond (CMB) program. Under the CMB program, CMHC guarantees the bonds of a special purpose trust, Canada Housing Trust (CHT). CHT uses the proceeds of its bond issuance to finance the purchase of NHA MBS issued by Home Trust.

In these securitizations, the Company retains prepayment and interest rate risk and rewards related to the transferred mortgages. Due to retention of these risks and rewards, transferred mortgages are not derecognized and the securitization proceeds are accounted for as secured borrowing transactions. There are no expected credit losses on the securitized mortgage assets as the mortgages are insured against default. Further, the investors and CMHC have no recourse to other assets of either the Company or Home Trust in the event of failure of debtors to pay when due.

The following table presents the gross carrying amounts of mortgages transferred during the year, which are recorded on the consolidated balance sheets as securitized residential mortgages. The following table also presents the new securitization liabilities added during the year, which are secured by the mortgages and other pledged assets.

| (thousands of Canadian dollars) | 2011 | 2010 |
|---|---|---|
| Mortgages transferred in new securitizations | **$ 1,242,219** | $ 4,469,278 |
| Replacement assets transferred for CMB program | **630,578** | 698,252 |
| Non-Home Trust MBS and treasury bills transferred for CMB program | **342,266** | 2,954 |
| Gross carrying amount of mortgages and other assets transferred | **$ 2,215,063** | $ 5,170,484 |
| New securitization liabilities | **$ 1,240,236** | $ 4,394,792 |

### (b) Assets Pledged as Collateral

Mortgage loans and other assets used in securitization activities are pledged against the associated secured borrowings (securitization liabilities). As a requirement of the NHA MBS program, the Company assigns to CMHC all of its interest in existing mortgage pools. If the Company fails to make timely payment under an NHA MBS security, CMHC may enforce the assignment of the mortgages included in all the mortgage pools as well as other assets backing the securities issued.

The following table presents the principal value of the Company's mortgage loans and other assets securitized and pledged as collateral for the associated liabilities. The mortgages are recorded as securitized residential mortgages and other assets are recorded as pledged assets on the consolidated balance sheets.

| (thousands of Canadian dollars) | **December 31 2011** | December 31 2010 | January 1 2010 |
|---|---|---|---|
| Principal value of mortgages pledged as collateral | **$ 8,196,167** | $ 8,063,131 | $ 4,097,022 |
| Non-Home Trust MBS and treasury bills pledged as collateral | **341,588** | 2,954 | – |

### (c) Securitization Liabilities

Securitization liabilities represent the funding secured by insured mortgages and other assets assigned under the NHA MBS and the CMB programs. Proceeds received through securitization of these mortgages are recorded as CMB and MBS liabilities on the consolidated balance sheets of the Company. Accrued interest on these liabilities is classified in other liabilities as accrued interest payable on securitization liabilities.

MBS securitization liabilities are repaid on a monthly basis as the principal payments are collected from securitized loans. CMB liabilities are bullet bond liabilities with fixed maturities. Any principal collected against the securitized assets underlying CMB liabilities is used to purchase replacement assets.

Interest accrued on MBS liabilities is recorded in other liabilities on the consolidated balance sheets and is based on the MBS coupon.

### (d) Securitization Liability Maturities

| | | | | | **December 31 2011** | December 31 2010 | January 1 2010 |
|---|---|---|---|---|---|---|---|
| (thousands of Canadian dollars, except %) | **Within 1 Year** | **1 to 3 Years** | **3 to 5 Years** | **Over 5 Years** | **Total Book Value** | Total Book Value | Total Book Value |
| Mortgage-backed security liabilities | **$ 484,974** | **$ 1,052,453** | **$ 880,374** | **$ –** | **$ 2,417,801** | $ 2,826,105 | $ 1,191,552 |
| Effective yield | **2.4%** | **2.6%** | **2.5%** | **–** | **2.5%** | 2.5% | 3.9% |
| Canada Mortgage Bond liabilities | **175,492** | **2,206,027** | **2,954,328** | **895,427** | **6,231,274** | 5,278,473 | 2,964,904 |
| Effective yield | **4.4%** | **3.1%** | **2.3%** | **3.5%** | **2.8%** | 3.0% | 3.3% |
| | **$ 660,466** | **$ 3,258,480** | **$ 3,834,702** | **$ 895,427** | **$ 8,649,075** | $ 8,104,578 | $ 4,156,456 |

## NOTE 7 OTHER ASSETS

| (thousands of Canadian dollars) | **December 31 2011** | December 31 2010 | January 1 2010 |
|---|---|---|---|
| Accrued interest receivable | **$ 56,606** | $ 49,920 | $ 43,269 |
| Prepaid CMB coupon | **6,919** | 9,449 | 5,521 |
| Other prepaid assets and deferred items | **16,125** | 20,730 | 26,532 |
| | **$ 79,650** | $ 80,099 | $ 75,322 |

## NOTE 8 CAPITAL ASSETS

| (thousands of Canadian dollars) | Computer Equipment and Software | Office Furniture and Equipment | Leasehold Improvements | Total |
|---|---|---|---|---|
| | | | | **2011** |
| Cost | | | | |
| Balance at the beginning of the year | **$ 13,369** | **$ 6,882** | **$ 3,366** | **$ 23,617** |
| Additions | **3,133** | **24** | **373** | **3,530** |
| Balance at the end of the year | **16,502** | **6,906** | **3,739** | **27,147** |
| Accumulated amortization | | | | |
| Balance at the beginning of the year | **11,071** | **4,930** | **2,722** | **18,723** |
| Amortization expense | **2,305** | **393** | **354** | **3,052** |
| Balance at the end of the year | **13,376** | **5,323** | **3,076** | **21,775** |
| Carrying amount | **$ 3,126** | **$ 1,583** | **$ 663** | **$ 5,372** |

| (thousands of Canadian dollars) | Computer Equipment and Software | Office Furniture and Equipment | Leasehold Improvements | Total |
|---|---|---|---|---|
| | | | | 2010 |
| Cost | | | | |
| Balance at the beginning of the year | $ 10,748 | $ 6,736 | $ 3,221 | $ 20,705 |
| Additions | 2,621 | 146 | 145 | 2,912 |
| Balance at the end of the year | 13,369 | 6,882 | 3,366 | 23,617 |
| Accumulated amortization | | | | |
| Balance at the beginning of the year | 8,836 | 4,460 | 2,546 | 15,842 |
| Amortization expense | 2,235 | 470 | 176 | 2,881 |
| Balance at the end of the year | 11,071 | 4,930 | 2,722 | 18,723 |
| Carrying amount | $ 2,298 | $ 1,952 | $ 644 | $ 4,894 |
| Carrying amount at January 1, 2010 | $ 1,912 | $ 2,276 | $ 675 | $ 4,863 |

## NOTE 9 INTANGIBLE ASSETS

Intangible assets comprise internally developed software costs that include software costs related to the Company's new core banking system. This new core banking system was substantially completed during the fourth quarter of 2011, at which time amortization of these costs commenced. These costs will continue to be amortized over the next 10 years. The following table presents the net carrying amount of software costs for the new core banking system and other software costs as at December 31, 2011, December 31, 2010 and January 1, 2010, along with the changes in net carrying amount for 2011 and 2010.

| | 2011 | | | 2010 | | |
|---|---|---|---|---|---|---|
| (thousands of Canadian dollars) | **Core Banking System** | **Other Software Costs** | **Total** | Core Banking System | Other Software Costs | Total |
| Cost | | | | | | |
| Balance at the beginning of the year | **$ 46,410** | **$ 2,598** | **$ 49,008** | $ 25,112 | $ 2,456 | $ 27,568 |
| Additions from internal development | **15,783** | **896** | **16,679** | 21,298 | 142 | 21,440 |
| Balance at the end of the year | **62,193** | **3,494** | **65,687** | 46,410 | 2,598 | 49,008 |
| Accumulated amortization | | | | | | |
| Balance at the beginning of the year | **–** | **1,091** | **1,091** | – | 757 | 757 |
| Amortization expense | **330** | **349** | **679** | – | 334 | 334 |
| Balance at the end of the year | **330** | **1,440** | **1,770** | – | 1,091 | 1,091 |
| Carrying amount at the end of the year | **$ 61,863** | **$ 2,054** | **$ 63,917** | $ 46,410 | $ 1,507 | $ 47,917 |
| Carrying amount at January 1, 2010 | | | | $ 25,112 | $ 1,699 | $ 26,811 |

## NOTE 10 GOODWILL

The carrying amount of goodwill in relation to each of the Company's subsidiaries is as follows:

| (thousands of Canadian dollars) | **December 31 2011** | December 31 2010 | January 1 2010 |
|---|---|---|---|
| Home Trust | **$ 2,324** | $ 2,324 | $ 2,324 |
| PSiGate | **13,428** | 13,428 | 13,428 |
| | **$ 15,752** | $ 15,752 | $ 15,752 |

There have been no additions, disposals or impairment losses of goodwill during the year.

Goodwill is allocated to CGUs for the purpose of impairment testing, considering the business level at which goodwill is monitored for internal management purposes. The PSiGate goodwill is allocated to the PSiGate legal entity (the unit) and this unit is included in the consumer lending operating segment. Management has determined that the recoverable amount of the unit exceeds its carrying amount and that no impairment exists. The following information relates to the annual impairment test of the unit that was conducted during the fourth quarter of 2011.

The recoverable amount of the unit was determined on the basis of its fair value less costs to sell. The fair value of the unit was determined using a discounted cash flow methodology where estimated cash flows were projected to December 31, 2015 and assuming a terminal growth rate of 3.0% thereafter. A revenue growth rate of 10.0% was assumed over the period of projections with a stable gross margin percentage. Operating expenses considered necessary to support the expected growth were included and increased over the period of projections at an expected inflationary rate. Planned capital expenditures, also necessary to support expected growth, were incorporated.

A discount rate of 15.5% was used, which comprised a risk-free rate, equity risk premium, size premium and company-specific risk premium. The risk-free rate, equity risk premium and size premium were based on data from external sources whereas the company-specific risk premium was based on factors considered by management to be specific to PSiGate.

The discounted cash flow methodology used is most sensitive to the discount rate and revenue growth rate used. In consideration of this sensitivity, management determined that either an increase in the discount rate from 15.5% to 21.6% or a decrease in annual revenue growth from 10.0% to 1.1% for each year of the projection, assuming unchanged values for the other assumptions, would have caused the recoverable amount to equal the carrying amount.

## NOTE 11 DEPOSITS

| (thousands of Canadian dollars, except %) | | Payable on Demand | | Within 1 Year | | 1 to 3 Years | | 3 to 5 Years | | December 31 2011 Total | | December 31 2010 Total | | January 1 2010 Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Individuals | **$** | **62,746** | **$** | **4,507,627** | **$** | **2,763,046** | **$** | **405,518** | **$** | **7,738,937** | $ | 6,531,923 | $ | 6,432,142 |
| Businesses | | **–** | | **81,708** | | **90,923** | | **10,556** | | **183,187** | | 64,056 | | 39,614 |
| | **$** | **62,746** | **$** | **4,589,335** | **$** | **2,853,969** | **$** | **416,074** | **$** | **7,922,124** | $ | 6,595,979 | $ | 6,471,756 |
| Effective yield | | **–** | | **2.2%** | | **2.7%** | | **3.2%** | | **2.4%** | | 2.8% | | 3.0% |

## NOTE 12 SENIOR DEBT

The Company issued $150.0 million principal amount of 5.20% debentures on May 4, 2011. The debentures pay interest semi-annually on November 4 and May 4 in each year. The debentures mature on May 4, 2016 and are redeemable at the option of the Company upon 30 days written notice to the registered holder at a redemption price, equal to the greater of the Canada Yield Price and par, plus accrued and unpaid interest up to but excluding the date fixed for redemption.

## NOTE 13 OTHER LIABILITIES

| (thousands of Canadian dollars) | | December 31 2011 | | December 31 2010 | | January 1 2010 |
|---|---|---|---|---|---|---|
| Accrued interest payable on deposits | **$** | **77,737** | $ | 72,630 | $ | 76,564 |
| Accrued interest payable on securitization liabilities | | **22,195** | | 22,309 | | 13,417 |
| Dividends payable | | **6,925** | | 6,236 | | 5,901 |
| Other, including accounts payable and accrued liabilities | | **29,168** | | 39,379 | | 34,941 |
| | **$** | **136,025** | $ | 140,554 | $ | 130,823 |

## NOTE 14 CAPITAL

### (a) Authorized

An unlimited number of common shares with no par value
An unlimited number of preferred shares, issuable in series, to be designated as senior preferred shares
An unlimited number of preferred shares, issuable in series, to be designated as junior preferred shares

### (b) Common Shares Issued and Outstanding

| | **2011** | | | 2010 | | |
|---|---|---|---|---|---|---|
| (thousands) | **Number of Shares** | | **Amount** | Number of Shares | | Amount |
| Outstanding at the beginning of the year | **34,646** | **$** | **50,427** | 34,713 | $ | 45,396 |
| Options exercised | **135** | | **4,921** | 131 | | 5,309 |
| Repurchase of shares | **(156)** | | **(244)** | (198) | | (278) |
| Outstanding at the end of the year | **34,625** | **$** | **55,104** | 34,646 | $ | 50,427 |

### (c) Repurchase of Shares

During the year, 156,300 (2010 – 197,700) common shares were purchased for $7.9 million (2010 – $8.5 million). The purchase price of shares acquired through the Normal Course Issuer Bid is allocated between capital stock and retained earnings. The cost of the common shares was reduced by $0.2 million in 2011 (2010 – $0.3 million). The balance of the purchase price of $7.7 million (2010 – $8.2 million) was charged to retained earnings.

### (d) Stock Options

The details and changes in the issued and outstanding options are as follows:

| | | **2011** | | 2010 |
|---|---|---|---|---|
| (thousands, except per share amounts) | **Number of Shares** | **Weighted-average Exercise Price** | Number of Shares | Weighted-average Exercise Price |
| Outstanding at the beginning of the year | **1,066** | **$ 36.07** | 925 | $ 31.32 |
| Granted | **5** | **46.35** | 343 | 47.82 |
| Exercised | **(135)** | **28.33** | (147) | 34.17 |
| Forfeited | **(7)** | **47.92** | (55) | 34.66 |
| Outstanding at the end of the year | **929** | **$ 37.16** | 1,066 | $ 36.07 |
| Exercisable at the end of the year | **594** | **$ 34.40** | 421 | $ 33.06 |
| Weighted-average share price at date of exercise | | **$ 56.17** | | $ 43.87 |
| Weighted-average remaining contractual life in years | | **3.9** | | 5.9 |

The Company's stock option plan was approved by the shareholders of the Company on December 31, 1986. The plan was amended in 2002 to conform to the Toronto Stock Exchange's Revised Policy on Listed Company Share Incentive Arrangements. As at December 31, 2011, the maximum number of common shares that may be issued was 4,585,198, representing approximately 13.2% of the aggregate number of common shares. The exercise price of the options is fixed by the Board of Directors (the Board) at the time of issuance at the market price of such shares, subject to all applicable regulatory requirements. The market price per share must not be less than the weighted-average price at which the common shares of the Company trade on the Toronto Stock Exchange during the two trading days immediately preceding the date on which the option is approved by the Board. The exercise period of any option is limited to a period of seven years from the date of grant of the option. The period within which an option or portion thereof may be exercised by a participant is determined in each case by the Board. Stock options that are currently issued and outstanding vest at a rate of 25% per year over four years on the condition that set earnings per share targets are achieved for each year as established by the Board at the time of the grant.

During 2010, the Company approved an amendment to the employee stock option plan to provide stock appreciation rights that allow cash settlement of vested stock options, at the Company's discretion. During the year, no options were settled in cash (2010 – 23,750 options were settled in cash for $0.3 million). The Company does not anticipate additional cash settlements.

As at December 31, 2011, the exercise prices for stock options outstanding to acquire common shares ranged from $16.27 to $47.92 and are presented below along with the number of options exercisable and the respective expiry date.

| Stock Options Outstanding | Stock Options Exercisable | Exercise Price per Share (Canadian Dollars) | Expiry Date |
|---|---|---|---|
| 150,000 | 150,000 | $ 34.51[1] | 2/14/2012 |
| 20,000 | 20,000 | 33.76[1] | 3/7/2014 |
| 180,000 | 180,000 | 41.29[1] | 12/7/2014 |
| 165,000 | 123,750 | 16.27[2] | 12/8/2015 |
| 25,000 | 12,500 | 17.06[3] | 2/12/2016 |
| 15,000 | 7,500 | 31.87[3] | 5/5/2016 |
| 10,000 | 5,000 | 40.70[3] | 11/3/2016 |
| 22,500 | 11,250 | 41.06[3] | 12/2/2016 |
| 10,000 | 2,500 | 44.63[4] | 8/4/2017 |
| 326,000 | 81,500 | 47.92[4] | 12/1/2017 |
| 5,000 | – | 46.35[5] | 11/2/2018 |
| 928,500 | 594,000 | $ 34.40 | |

[1] In 2007, the Company granted certain employees the right to receive stock options if certain performance criteria were met. As at December 31, 2011, four levels of performance had been met for 350,000 options. As a result, 100% of these contingently assumable options have been included in the computation of diluted income per common share.

[2] In 2008, the Company granted certain employees the right to receive stock options if certain performance criteria were met. As at December 31, 2011, three levels of performance had been met for 165,000 options. As a result, 75% of these contingently assumable options have been included in the computation of diluted income per common share.

[3] In 2009, the Company granted certain employees the right to receive stock options if certain performance criteria were met. As at December 31, 2011, two levels of performance had been met for 72,500 options. As a result, 50% of these contingently assumable options have been included in the computation of diluted income per common share.

[4] In 2010, the Company granted certain employees the right to receive stock options if certain performance criteria were met. As at December 31, 2011, one of the performance criteria had been met for 336,000 options. As a result, 25% of these contingently assumable options have been included in the computation of diluted income per common share.

[5] In 2011, the Company granted certain employees the right to receive stock options if certain performance criteria were met. As at December 31, 2011, none of the performance criteria had been met for 5,000 options. As a result, the contingently assumable options have not been included in the computation of diluted income per common share.

The Company determines the fair value of options granted using the Black-Scholes option pricing model. The weighted-average fair value of the options granted during the year was $14.93 (2010 – $16.65).

The following assumptions were used to determine the fair value of each of the following option grants on the date of grant:

| (thousands of Canadian dollars, except % and years) | **November 2011** | December 2010 | August 2010 |
|---|---|---|---|
| Fair value of options granted | **$ 14.93** | $ 16.61 | $ 17.85 |
| Share price | **$ 44.69** | $ 48.36 | $ 46.25 |
| Exercise price | **$ 46.35** | $ 47.92 | $ 44.63 |
| Expected share price volatility | **36.1%** | 36.5% | 36.9% |
| Option life | **7.0** | 6.0 | 7.0 |
| Expected period until exercise in years | **7.0** | 6.0 | 7.0 |
| Forfeiture rate | **6.8%** | 19.6% | 24.9% |
| Expected dividend yield | **1.62%** | 1.39% | 1.11% |
| Risk-free rate of return | **2.07%** | 2.72% | 2.58% |

The above assumptions for expected volatility were determined purely on the basis of historical volatility.

The Company determines the fair value of stock options on their grant date and records this amount as compensation expense over the period that the stock options vest, with a corresponding increase to contributed surplus. When these stock options are exercised, the Company records the amount of proceeds, together with the amount recorded in contributed surplus, in capital stock.

### (e) Deferred Share Units

The Company grants deferred share units (DSUs) to Directors of the Company. Under the plan, the Directors may annually elect to accept remuneration in the form of cash, cash and DSUs or DSUs prior to the beginning of the year. DSUs earn dividend equivalents in the form of additional DSUs at the same rate as dividends on common shares. The participant is not allowed to settle the DSUs until retirement or termination of directorship. The cash value of the DSUs is equivalent to the market value of common shares when settlement takes place. The value of the DSU liability as at December 31, 2011 was $0.53 million (2010 – $0.43 million). As of December 31, 2011, there were 10,765 DSUs outstanding (2010 – 9,670).

### (f) Share-Based Compensation Expense

The expense recognized in the consolidated statements of income in relation to share-based compensation was as follows:

| (thousands of Canadian dollars) | 2011 | 2010 |
|---|---|---|
| Expense arising from equity-settled share-based payment transactions | $ 2,400 | $ 2,125 |
| DSUs (representing all expenses arising from cash-settled share-based payment transactions) | 50 | 22 |
| | $ 2,450 | $ 2,147 |

### (g) Income per Common Share

Basic income per common share is determined as net income for the year divided by the average number of common shares outstanding of 34,677 (2010 – 34,697).

Diluted income per common share is determined as net income for the year divided by the average number of common shares outstanding of 34,677 (2010 – 34,697) plus the stock options potentially exercisable, as determined under the treasury stock method, of 110 (2010 – 79) for a total of 34,787 (2010 – 34,776) diluted common shares.

### (h) Capital Management

The Company has a capital management policy that governs the quantity and quality of capital held. The objective of the policy is to meet regulatory capital requirements, while also providing a sufficient return to investors. The Risk and Capital Committee and the Board of Directors annually review the policy and monitor compliance with the policy on a quarterly basis.

The Company's subsidiary, Home Trust, is subject to the regulatory capital requirements governed by the Office of the Superintendent of Financial Institutions Canada (OSFI). These requirements are consistent with international standards (Basel II) set by the Bank for International Settlements. Home Trust follows the Standardized Approach for calculating credit risk and the Basic Indicator Approach for operational risk.

The regulatory capital position of Home Trust was as follows:

| (thousands of Canadian dollars, except ratios and multiple) | December 31 2011 | December 31 2010 (Canadian GAAP[4]) |
|---|---|---|
| Tier 1 capital | | |
| Capital stock | $ 23,497 | $ 23,497 |
| Contributed surplus | 951 | 951 |
| Retained earnings | 717,223 | 658,530 |
| Accumulated other comprehensive loss[1] | (4,229) | – |
| IFRS transition adjustment | 49,188 | – |
| Total | 786,630 | 682,978 |
| Tier 2 capital | | |
| Collective allowance for credit losses[2] | 29,440 | 29,153 |
| Accumulated other comprehensive income[3] | – | 4,545 |
| Subordinated debentures | 115,000 | 15,000 |
| Total | 144,440 | 48,698 |
| Total regulatory capital | $ 931,070 | $ 731,676 |
| Risk-weighted assets for | | |
| Credit risk | $ 4,068,823 | $ 3,423,017 |
| Operational risk | 480,873 | 354,250 |
| Total risk-weighted assets | $ 4,549,696 | $ 3,777,267 |
| Regulated capital to risk-weighted assets | | |
| Tier 1 capital | 17.3% | 18.1% |
| Tier 2 capital | 3.2% | 1.3% |
| Total regulatory capital ratio | 20.5% | 19.4% |
| Assets to regulatory capital multiple | 14.4 | 10.5 |

1 Accumulated other comprehensive loss relates to unrealized losses on certain available for sale equity securities, net of tax, which decrease Tier 1 capital.

2 The Company is allowed to include its collective allowance for credit losses up to a prescribed percentage of risk-weighted assets in Tier 2 capital. At December 31, 2011, the Company's collective allowance represented 0.65% of risk-weighted assets.

3 Accumulated other comprehensive income relates to unrealized gains on certain available for sale equity securities, net of tax, which increase Tier 2 capital.

4 Regulatory capital and calculations as at December 31, 2010 are based on previous Canadian GAAP balances.

OSFI considers a financial institution to be well-capitalized if it maintains a Tier 1 capital ratio of 7% and a Total capital ratio of 10%. Home Trust Company is in compliance with the OSFI capital guidelines.

Under IFRS transition relief permitted by OSFI, the Company has elected to amortize the December 31, 2010 IFRS retained earnings transition adjustment over eight quarters beginning March 31, 2011. The IFRS retained earnings transition adjustment for regulatory capital calculation purposes is the difference between retained earnings under Canadian GAAP and under IFRS at December 31, 2010. In the absence of this election, the Company's Tier 1 and Total capital would be $737.4 million and $881.9 million, respectively, at December 31, 2011.

## NOTE 15 ACCUMULATED OTHER COMPREHENSIVE INCOME

| (thousands of Canadian dollars) | **December 31 2011** | December 31 2010 | January 1 2010 |
|---|---|---|---|
| Unrealized (losses) gains on | | | |
| Available for sale securities | **$ (5,764)** | $ 7,653 | $ 12,938 |
| Income tax (recovery) expense | **(1,623)** | 1,747 | 2,733 |
| | **(4,141)** | 5,906 | 10,205 |
| Unrealized losses on | | | |
| Cash flow hedges | **(6,768)** | – | – |
| Income tax recovery | **(1,718)** | – | – |
| | **(5,050)** | – | – |
| Accumulated other comprehensive (loss) income | **$ (9,191)** | $ 5,906 | $ 10,205 |

## NOTE 16 INCOME TAXES

### (a) Reconciliation of Income Taxes

The combined federal and provincial income tax rate varies each year according to changes in the statutory tax rate imposed by the federal and provincial governments. The effective rate of income tax in the consolidated statements of income is different from the combined federal and provincial income tax rate of 28.14% (2010 – 30.78%).

| (thousands of Canadian dollars) | **2011** | 2010 |
|---|---|---|
| Income before income taxes | **$ 256,313** | $ 213,291 |
| Income taxes at statutory combined federal and provincial income tax rates | **$ 72,126** | $ 65,650 |
| Increase (decrease) in income taxes at statutory income tax rates resulting from | | |
| Tax-exempt income | **(5,182)** | (5,461) |
| Non-deductible expenses | **743** | 440 |
| Future tax rate changes | **(878)** | (1,787) |
| Other | **(576)** | (303) |
| Income tax | **$ 66,233** | $ 58,539 |

### (b) Reconciliation of Income Tax Rates

| | **2011** | 2010 |
|---|---|---|
| Statutory income tax rate | **28.14%** | 30.78% |
| Increase (reduction) in income tax rate resulting from | | |
| Tax-exempt income | **(2.02)%** | (2.56)% |
| Non-deductible expenses | **0.29%** | 0.21% |
| Future tax rate changes | **(0.34)%** | (0.84)% |
| Other | **(0.23)%** | (0.14)% |
| Effective income tax | **25.84%** | 27.45% |

### (c) Sources of Deferred Tax Balances

| (thousands of Canadian dollars) | **December 31 2011** | December 31 2010 | January 1 2010 |
|---|---|---|---|
| Deferred tax liabilities | | | |
| Commissions | **$ 6,058** | $ 5,904 | $ 6,754 |
| Finders' fees, net of commitment fees | **11,855** | 14,750 | 9,962 |
| Securitization transaction costs | **8,419** | 10,652 | 4,064 |
| Swaps | **4,046** | 5,183 | 567 |
| Development costs | **15,855** | 11,060 | 7,232 |
| Other | **500** | 344 | – |
| | **46,733** | 47,893 | 28,579 |
| Deferred tax assets | | | |
| Allowance for credit losses | **6,693** | 7,780 | 7,549 |
| Other | **–** | – | 4,201 |
| | **6,693** | 7,780 | 11,750 |
| | **$ 40,040** | $ 40,113 | $ 16,829 |

Capital losses totalling $2.8 million are available to reduce capital gains in future years. The future tax benefits arising from application of these losses have not been reflected in the consolidated statements of income and changes in shareholders' equity.

## NOTE 17 EMPLOYEE BENEFITS

### (a) Employee Share Purchase Plan

Under the Employee Share Purchase Plan, qualifying employees can choose each year to have up to 10% of their annual base earnings withheld to purchase common shares. The Company matches 50% of the employees' contribution amount. All contributions are used by the plan's trustee to purchase the common shares during each pay period in the open market. The Company's contributions are fully vested immediately. The Company's contributions are expensed as paid and totalled $0.7 million for 2011 (2010 – $0.6 million).

### (b) Employee Retirement Savings Plan

During the year, Home Trust contributed $0.7 million (2010 – $0.6 million) to the employee group registered retirement savings plan.

## NOTE 18 COMMITMENTS AND CONTINGENCIES

### (a) Lease Commitments

The Company has entered into commercial leases on premises and property. There are no restrictions imposed by lease arrangements. Future minimum lease payments under non-cancellable operating leases are as follows:

| (thousands of Canadian dollars) | **December 31 2011** | December 31 2010 | January 1 2010 |
|---|---|---|---|
| Within one year | **$ 3,283** | $ 3,989 | $ 3,789 |
| After one year but not more than five years | **10,658** | 9,339 | 10,704 |
| More than five years | **16,305** | – | 3,342 |
| | **$ 30,246** | $ 13,328 | $ 17,835 |

Lease payments recognized as expense in the consolidated statements of income in 2011 amounted to $7.7 million (2010 – $6.8 million).

### (b) Credit Commitments

Outstanding commitments for funding on mortgages amounted to $612.4 million as at December 31, 2011 (2010 – $458.8 million). Commitments for loans remain open for various dates through March 2012. The average rate on mortgage commitments is 5.02% (2010 – 4.65%).

The Company also has contractual commitments to extend credit to its clients for its credit card products. The contractual commitments for these products represent the maximum potential credit risk, assuming the contractual amounts are fully utilized and the client defaults and collection efforts are unsuccessful. At December 31, 2011, these contractual commitments in aggregate were $476.6 million (2010 – $416.4 million), of which $89.6 million (2010 – $76.5 million) has not been drawn by customers. In addition, outstanding commitments for new Equityline *Visa* accounts were $10.5 million at December 31, 2011 (2010 – $5.1 million).

These amounts in aggregate are not indicative of total future cash requirements. Management does not expect any material adverse consequence to the Company's financial position to result from these commitments. Secured credit cards have spending limits restricted by collateral held by the Company.

### (c) Directors' and Officers' Indemnification

The Company indemnifies Directors and officers, to the extent permitted by law, against certain claims that may be made against them as a result of their being, or having been, Directors and officers at the request of the Company. The nature of this indemnification prevents the Company from making a reasonable estimate of the maximum potential amount the Company could be required to pay to third parties. Management believes that the likelihood that the Company would incur a significant liability under these indemnifications is remote. The Company has purchased Directors' and officers' liability insurance.

### (d) Contingencies

During 2011, the Company became aware of alleged irregularities regarding three of its loans with a total principal amount of $4.6 million. The borrowers are disputing the validity of the Company's security in the Ontario Court. It is not currently possible to reasonably determine the outcome of this matter or to estimate the amount of loss, if any. A specific provision has not been recorded for these loans but these loans have been classified as non-performing residential loans.

## NOTE 19 DERIVATIVE FINANCIAL INSTRUMENTS

The Company utilizes interest rate swaps and forward contracts to hedge exposures to interest rate risk. The Company generally uses its derivative instruments in hedge accounting relationships to minimize volatility in earnings caused by changes in interest rates. When a hedging derivative functions effectively, gains, losses, revenues or expenses of the hedging derivative will offset the gains, losses, revenues or expenses of the hedged item. To qualify for hedge accounting treatment, the hedging relationship is formally designated and documented at its inception. The documentation describes the particular risk management objective and strategy for the hedge and the specific asset, liability or cash flow being hedged and how effectiveness of the hedge is assessed. Changes in the fair value of the derivative instruments must be highly effective at offsetting either the changes in the fair value of the risk on the on-balance sheet asset or liability being hedged or the changes in the amount of future cash flows.

Fair value represents point-in-time estimates that may change in subsequent reporting periods due to market conditions or other factors. Fair value for derivatives is determined from swap curves adjusted for credit risks. Swap curves are obtained directly from market sources or calculated from market prices.

Hedge effectiveness is assessed at the inception of the hedge and on an ongoing basis, retrospectively and prospectively, over the life of the hedge. Any ineffectiveness in the hedging relationship is recognized immediately through non-interest expense. In January 2011, the Company restructured certain interest rate swaps to rebalance the interest rate hedges and to meet hedge accounting requirements. The Company booked an unrealized loss of $3.7 million in income through net realized and unrealized gain (loss) on derivatives.

#### *Cash Flow Hedging Relationships*

The Company uses bond forward contracts or interest rate swaps to hedge the economic value exposure of movements in interest rates between the time that the Company determines that it will likely incur liabilities pursuant to asset securitization, and the time the securitization transaction is complete and the liabilities are incurred. The intent of the bond forward or interest rate swap is to manage the change in cash flows of the future interest payments on the anticipated secured borrowings through asset securitization. Fair value changes recorded in AOCI are reclassified into net interest income over the term of the hedged item up to a maximum of 2016.

The following table presents gains or losses related to cash flow hedges included in the Company's financial results:

| (thousands of Canadian dollars) | 2011 | 2010 |
|---|---|---|
| Fair value changes recorded in OCI | $ (7,386) | $ – |
| Fair value changes recorded in non-interest income | (545) | – |
| Amounts reclassified from OCI to net interest income | (618) | – |

### *Fair Value Hedging Relationships*

The Company uses interest rate swaps to hedge changes in the fair value of long-term fixed rate liabilities associated with changes in market interest rates.

The following table presents gains or losses related to fair value hedges included in the Company's financial results:

| (thousands of Canadian dollars) | 2011 | 2010 |
|---|---|---|
| Fair value changes recorded on interest rate swaps[1] | $ 53,561 | $ (3,116) |
| Fair value changes of hedged fixed-rate liabilities for interest rate risk[2] | (53,326) | 3,913 |
| Hedge ineffectiveness recognized in non-interest income | $ 235 | $ 797 |

1 Unrealized gains and losses on hedging derivatives (interest rate swaps) are recorded as derivative assets or liabilities, as appropriate, on the consolidated balance sheets.

2 Unrealized gains and losses on hedged items (fixed rate liabilities) for the risk being hedged are recorded as part of the associated fixed rate liability on the consolidated balance sheets.

### *Other Derivative Gains and Losses*

From time to time, the Company enters into derivative positions to hedge interest rate risk and such derivatives are not designated as hedges for accounting purposes. The changes in fair value of such derivatives flow directly to the consolidated statements of income. The Company recorded losses of $3.6 million in the year on these derivatives. In 2010, the Company's transition year to IFRS, the Company was not able to apply hedge accounting to all qualifying hedges, resulting in a net gain of $9.8 million on these derivatives.

As at December 31, 2011, December 31, 2010 and January 1, 2010, the outstanding interest rate and bond forward contracts positions were as follows:

| (thousands of Canadian dollars) | | | | | | | As at December 31, 2011 |
|---|---|---|---|---|---|---|---|
| Year of Maturity | Notional Amount | Current Replacement Cost | Credit Equivalent Amount | Risk-weighted Balance | Derivative Asset | Derivative Liability | Net Fair Market Value |
| Hedging swaps | | | | | | | |
| Maturing in 2012 | $ 64,400 | $ 2,682 | $ 2,682 | $ 536 | $ 2,682 | $ – | $ 2,682 |
| Maturing in 2013 | 265,200 | 10,031 | 11,358 | 2,271 | 10,031 | – | 10,031 |
| Maturing in 2014 | 230,500 | 10,032 | 11,004 | 2,201 | 9,766 | – | 9,766 |
| Maturing in 2015 | 798,914 | 33,786 | 37,781 | 7,556 | 33,786 | – | 33,786 |
| Maturing in 2016 | 192,200 | 8,302 | 9,113 | 1,823 | 8,302 | (92) | 8,210 |
| Maturing in 2018 | 25,700 | 1,714 | 2,099 | 420 | 1,714 | – | 1,714 |
| Maturing in 2020 | 59,000 | 6,134 | 7,019 | 1,404 | 6,134 | – | 6,134 |
| | 1,635,914 | 72,681 | 81,056 | 16,211 | 72,415 | (92) | 72,323 |
| Non-hedging swaps[1] | | | | | | | |
| Maturing in 2012 | 18,100 | 9 | 9 | 2 | 9 | – | 9 |
| Maturing in 2016 | 100,000 | – | – | – | – | (3,366) | (3,366) |
| | 118,100 | 9 | 9 | 2 | 9 | (3,366) | (3,357) |
| Total | $ 1,754,014 | $ 72,690 | $ 81,065 | $ 16,213 | $ 72,424 | $ (3,458) | $ 68,966 |

(thousands of Canadian dollars) As at December 31, 2010

| Year of Maturity | Notional Amount | Current Replacement Cost | Credit Equivalent Amount | Risk-weighted Balance | Derivative Asset | Derivative Liability | Net Fair Market Value |
|---|---|---|---|---|---|---|---|
| Hedging swaps | | | | | | | |
| Maturing in 2015 | $ 705,964 | $ 1,292 | $ 2,991 | $ 598 | $ 1,292 | $ (4,408) | $ (3,116) |
| | 705,964 | 1,292 | 2,991 | 598 | 1,292 | (4,408) | (3,116) |
| Non-hedging swaps[1] | | | | | | | |
| Maturing in 2011 | 32,231 | 773 | 773 | 155 | 773 | – | 773 |
| Maturing in 2012 | 56,017 | 3,506 | 3,729 | 746 | 3,506 | (75) | 3,431 |
| Maturing in 2013 | 188,795 | 8,420 | 9,076 | 1,815 | 8,420 | (28) | 8,392 |
| Maturing in 2014 | 138,317 | 6,121 | 6,636 | 1,327 | 6,121 | (592) | 5,529 |
| Maturing in 2015 | 92,436 | 2,291 | 2,374 | 475 | 2,291 | (2,188) | 103 |
| Maturing in 2018 | 6,236 | 71 | 94 | 19 | 71 | (318) | (247) |
| Maturing in 2020 | 6,872 | 1,350 | 1,441 | 288 | 1,350 | (338) | 1,012 |
| | 520,904 | 22,532 | 24,123 | 4,825 | 22,532 | (3,539) | 18,993 |
| Non-hedging bond forwards[2] | | | | | | | |
| Maturing in 2015 | 36,300 | 44 | 104 | 21 | 44 | (92) | (48) |
| Maturing in 2016 | 75,000 | – | – | – | – | (207) | (207) |
| Maturing in 2020 | 140,900 | 289 | 1,094 | 219 | 289 | (763) | (474) |
| | 252,200 | 333 | 1,198 | 240 | 333 | (1,062) | (729) |
| Total | $ 1,479,068 | $ 24,157 | $ 28,312 | $ 5,663 | $ 24,157 | $ (9,009) | $ 15,148 |

(thousands of Canadian dollars) As at January 1, 2010

| Year of Maturity | Notional Amount | Current Replacement Cost | Credit Equivalent Amount | Risk-weighted Balance | Derivative Asset | Derivative Liability | Net Fair Market Value |
|---|---|---|---|---|---|---|---|
| Non-hedging swaps[1] | | | | | | | |
| Maturing in 2011 | $ 18,511 | $ 1,038 | $ 1,130 | $ 226 | $ 1,038 | $ – | $ 1,038 |
| Maturing in 2012 | 37,088 | 3,498 | 3,659 | 732 | 3,498 | (189) | 3,309 |
| Maturing in 2013 | 125,130 | 5,710 | 6,187 | 1,237 | 5,710 | (2,621) | 3,089 |
| Maturing in 2014 | 46,259 | 488 | 584 | 117 | 488 | (4,535) | (4,047) |
| Maturing in 2018 | 2,716 | – | – | – | – | (1,966) | (1,966) |
| Maturing in 2020 | 326 | – | – | – | – | (1,773) | (1,773) |
| | 230,030 | 10,734 | 11,560 | 2,312 | 10,734 | (11,084) | (350) |
| Non-hedging bond forwards[2] | | | | | | | |
| Maturing in 2014 | 17,200 | 307 | 394 | 79 | 307 | – | 307 |
| Maturing in 2015 | 70,000 | 327 | 851 | 170 | 327 | (15) | 312 |
| Maturing in 2018 | 74,700 | 1,459 | 2,580 | 516 | 1,459 | – | 1,459 |
| Maturing in 2020 | 21,900 | 359 | 687 | 137 | 359 | – | 359 |
| | 183,800 | 2,452 | 4,512 | 902 | 2,452 | (15) | 2,437 |
| Total | $ 413,830 | $ 13,186 | $ 16,072 | $ 3,214 | $ 13,186 | $ (11,099) | $ 2,087 |

1 Non-hedging swaps include swaps that were not in hedge accounting relationships in 2010 or do not meet hedging criteria in 2011.

2 The term of the bond forward contracts is based on the term of the underlying bonds.

The notional amount represents the amount to which the rate or price is applied in order to calculate the amount of cash exchanged under the contract. Notional amounts do not represent an asset or liability recorded on the consolidated balance sheets.

## NOTE 20 CURRENT AND NON-CURRENT ASSETS AND LIABILITIES

The following table presents an analysis of each asset and liability line item by amounts expected to be recovered or settled within one year or after one year as at December 31, 2011, December 31, 2010 and January 1, 2010.

| | **As at December 31, 2011** | | | As at December 31, 2010 | | |
|---|---|---|---|---|---|---|
| (thousands of Canadian dollars) | **Within 1 Year** | **After 1 Year** | **Total** | Within 1 Year | After 1 Year | Total |
| Assets | | | | | | |
| Cash resources | **$ 665,806** | **$ –** | **$ 665,806** | $ 846,824 | $ – | $ 846,824 |
| Available for sale securities | **66,769** | **324,985** | **391,754** | 171,391 | 252,777 | 424,168 |
| Pledged securities | **320,535** | **21,053** | **341,588** | – | 2,954 | 2,954 |
| Residential mortgages | **3,862,265** | **2,477,618** | **6,339,883** | 2,063,378 | 2,620,149 | 4,683,527 |
| Securitized residential mortgages | **1,333,116** | **6,910,234** | **8,243,350** | 1,465,415 | 6,651,221 | 8,116,636 |
| Non-residential mortgages | **472,390** | **473,832** | **946,222** | 326,470 | 511,783 | 838,253 |
| Personal and credit card loans | **398,446** | **161,747** | **560,193** | 347,686 | 105,653 | 453,339 |
| Collective allowance for credit losses | **(19,627)** | **(9,813)** | **(29,440)** | (19,435) | (9,718) | (29,153) |
| Income taxes receivable | **–** | **–** | **–** | 9,451 | – | 9,451 |
| Derivative assets | **2,682** | **69,742** | **72,424** | 773 | 23,384 | 24,157 |
| Other assets | **79,650** | **–** | **79,650** | 80,099 | – | 80,099 |
| Capital assets | **–** | **5,372** | **5,372** | – | 4,894 | 4,894 |
| Intangible assets | **–** | **63,917** | **63,917** | – | 47,917 | 47,917 |
| Goodwill | **–** | **15,752** | **15,752** | – | 15,752 | 15,752 |
| Total assets | **$ 7,182,032** | **$ 10,514,439** | **$ 17,696,471** | $ 5,292,052 | $ 10,226,766 | $ 15,518,818 |
| Liabilities | | | | | | |
| Deposits payable on demand | **$ 62,746** | **$ –** | **$ 62,746** | $ 50,359 | $ – | $ 50,359 |
| Deposits payable on a fixed date | **4,589,335** | **3,270,043** | **7,859,378** | 3,454,013 | 3,091,607 | 6,545,620 |
| Senior debt | **–** | **153,336** | **153,336** | – | – | – |
| Mortgage-backed security liabilities | **484,974** | **1,932,827** | **2,417,801** | 770,862 | 2,055,243 | 2,826,105 |
| Canada Mortgage Bond liabilities | **175,492** | **6,055,782** | **6,231,274** | 106,641 | 5,171,832 | 5,278,473 |
| Derivative liabilities | **–** | **3,458** | **3,458** | – | 9,009 | 9,009 |
| Income taxes payable | **17,628** | **–** | **17,628** | – | – | – |
| Other liabilities | **136,025** | **–** | **136,025** | 140,554 | – | 140,554 |
| Deferred tax liabilities | **–** | **40,040** | **40,040** | – | 40,113 | 40,113 |
| Total liabilities | **$ 5,466,200** | **$ 11,455,486** | **$ 16,921,686** | $ 4,522,429 | $ 10,367,804 | $ 14,890,233 |
| Net | **$ 1,715,832** | **$ (941,047)** | **$ 774,785** | $ 769,623 | $ (141,038) | $ 628,585 |

| | | | As at at January 1, 2010 |
|---|---|---|---|
| (thousands of Canadian dollars) | Within 1 Year | After 1 Year | Total |
| Assets | | | |
| Cash resources | $ 930,134 | $ – | $ 930,134 |
| Held for trading securities | 99,938 | – | 99,938 |
| Available for sale securities | 162,560 | 332,042 | 494,602 |
| Residential mortgages | 1,421,625 | 3,051,630 | 4,473,255 |
| Securitized residential mortgages | 790,245 | 3,336,462 | 4,126,707 |
| Non-residential mortgages | 270,644 | 437,781 | 708,425 |
| Personal and credit card loans | 314,190 | 28,728 | 342,918 |
| Collective allowance for credit losses | (18,529) | (9,264) | (27,793) |
| Income taxes receivable | 6,466 | – | 6,466 |
| Derivative assets | – | 13,186 | 13,186 |
| Other assets | 75,322 | – | 75,322 |
| Capital assets | – | 4,863 | 4,863 |
| Intangible assets | – | 26,811 | 26,811 |
| Goodwill | – | 15,752 | 15,752 |
| Total assets | $ 4,052,595 | $ 7,237,991 | $ 11,290,586 |
| Liabilities | | | |
| Deposits payable on demand | $ 38,223 | $ – | $ 38,223 |
| Deposits payable on a fixed date | 3,367,182 | 3,066,351 | 6,433,533 |
| Mortgage-backed security liabilities | 321,665 | 869,887 | 1,191,552 |
| Canada Mortgage Bond liabilities | – | 2,964,904 | 2,964,904 |
| Derivative liabilities | – | 11,099 | 11,099 |
| Other liabilities | 130,823 | – | 130,823 |
| Deferred tax liabilities | – | 16,829 | 16,829 |
| Total liabilities | $ 3,857,893 | $ 6,929,070 | $ 10,786,963 |
| Net | $ 194,702 | $ 308,921 | $ 503,623 |

## NOTE 21 INTEREST RATE SENSITIVITY

The Company is exposed to interest rate risk as a result of a difference, or gap, between the maturity or repricing date of interest-sensitive assets and liabilities. The following tables show the gap position at December 31, 2011, December 31, 2010 and January 1, 2010 for selected period intervals. Figures in parentheses represent an excess of liabilities over assets or a negative gap position.

This schedule reflects the contractual maturities of both assets and liabilities, adjusted for assumptions regarding the effective change in the maturity date as a result of a mortgage becoming impaired and for credit commitments and derivatives.

Based on the current interest rate gap position at December 31, 2011, the Company estimates that a 100 basis point decrease in interest rates would decrease net interest income after tax, other comprehensive income and net present value of shareholders' equity over the next 12 months by $8.1 million, $2.4 million and $5.9 million, respectively. A 100 basis point increase in interest rates would increase net interest income after tax, other comprehensive income and net present value of shareholders' equity over the next 12 months by $8.1 million, $2.4 million and $4.2 million, respectively.

**As at December 31, 2011**

| (thousands of Canadian dollars, except %) | Floating | 0 to 3 Months | 3 to 6 Months | 6 to 12 Months | 1 to 3 Years | Over 3 Years | Non-interest Sensitive | Total |
|---|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | | |
| Cash resources | $ 192,095 | $ 473,551 | $ 144 | $ – | $ – | $ – | $ 16 | $ 665,806 |
| Weighted-average interest rate | 0.8% | 1.0% | 1.1% | – | – | – | – | 0.9% |
| Securities | – | 362,340 | 13,113 | 11,851 | 185,950 | 160,088 | – | 733,342 |
| Weighted-average interest rate | – | 1.5% | 5.7% | 5.0% | 4.8% | 4.5% | – | 3.1% |
| Non-securitized mortgages and loans | – | 1,363,234 | 693,149 | 2,480,044 | 2,536,926 | 747,292 | (3,787) | 7,816,858 |
| Weighted-average interest rate | – | 6.8% | 5.6% | 5.5% | 4.4% | 5.2% | – | 5.4% |
| Securitized residential mortgages | – | 2,721,818 | 161,040 | 491,943 | 2,748,791 | 2,119,758 | – | 8,243,350 |
| Weighted-average interest rate | – | 2.8% | 5.1% | 4.8% | 4.5% | 4.3% | – | 3.9% |
| Other assets | – | 72,424 | – | – | – | – | 164,691 | 237,115 |
| **Total** | $ 192,095 | $ 4,993,367 | $ 867,446 | $ 2,983,838 | $ 5,471,667 | $ 3,027,138 | $ 160,920 | $17,696,471 |
| **Weighted–average interest rate** | 0.8% | 3.6% | 5.5% | 5.4% | 4.5% | 4.5% | – | 4.4% |
| **Liabilities and shareholders' equity** | | | | | | | | |
| Deposits payable on demand | $ 6 | $ – | $ – | $ – | $ – | $ – | $ 62,740 | $ 62,746 |
| Deposits payable at a fixed rate | – | 436,139 | 1,074,219 | 3,078,977 | 2,853,969 | 416,074 | – | 7,859,378 |
| Weighted-average interest rate | – | 2.4% | 2.4% | 2.1% | 2.7% | 3.2% | – | 2.4% |
| Senior debt | – | – | – | – | – | 153,336 | – | 153,336 |
| Weighted-average interest rate | – | – | – | – | – | 5.3% | – | 5.3% |
| Securitization liabilities | – | 2,581,640 | 154,101 | 468,760 | 3,128,642 | 2,315,932 | – | 8,649,075 |
| Weighted-average interest rate | – | 1.9% | 3.3% | 2.9% | 2.9% | 3.2% | – | 2.7% |
| Other liabilities | – | 3,458 | – | – | – | – | 193,693 | 197,151 |
| Shareholders' equity | – | – | – | – | – | – | 774,785 | 774,785 |
| **Total** | $ 6 | $ 3,021,237 | $ 1,228,320 | $ 3,547,737 | $ 5,982,611 | $ 2,885,342 | $ 1,031,218 | $17,696,471 |
| **Weighted-average interest rate** | – | 2.0% | 2.5% | 2.2% | 2.8% | 3.3% | – | 2.4% |
| | $ 192,089 | $ 1,972,130 | $ (360,874) | $ (563,899) | $ (510,944) | $ 141,796 | $ (870,298) | $ – |
| Credit commitments | – | (521,051) | 186,562 | 17,772 | 231,460 | 85,257 | – | – |
| Weighted-average interest rate | – | 4.8% | 4.8% | 5.2% | 5.1% | 4.1% | – | – |
| **Interest rate sensitivity gap** | $ 192,089 | $ 1,451,079 | $ (174,312) | $ (546,127) | $ (279,484) | $ 227,053 | $ (870,298) | $ – |
| **Cumulative gap** | $ 192,089 | $ 1,643,168 | $1,468,856 | $ 922,729 | $ 643,245 | $ 870,298 | $ – | $ – |
| **Cumulative gap as a percentage of total assets** | 1.1% | 9.3% | 8.3% | 5.2% | 3.6% | 4.9% | – | – |

As at December 31, 2010

| (thousands of Canadian dollars, except %) | Floating | 0 to 3 Months | 3 to 6 Months | 6 to 12 Months | 1 to 3 Years | Over 3 Years | Non-interest Sensitive | Total |
|---|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | | |
| Cash resources | $ 82,211 | $ 693,283 | $ – | $ 71,330 | $ – | $ – | $ – | $ 846,824 |
| Weighted-average interest rate | 1.0% | 1.0% | – | 1.2% | – | – | – | 1.0% |
| Securities | – | 55,785 | 38,759 | 30,629 | 105,994 | 195,955 | – | 427,122 |
| Weighted-average interest rate | – | 2.5% | 3.1% | 5.6% | 3.4% | 5.5% | – | 4.4% |
| Non-securitized mortgages and loans | – | 1,021,026 | 381,285 | 1,349,209 | 2,206,878 | 957,612 | 29,956 | 5,945,966 |
| Weighted-average interest rate | – | 6.5% | 6.5% | 5.8% | 5.7% | 5.5% | – | 5.9% |
| Securitized residential mortgages | – | 66,479 | 7,324 | 575,933 | 2,276,522 | 5,190,378 | – | 8,116,636 |
| Weighted-average interest rate | – | 5.4% | 5.3% | 5.1% | 5.0% | 3.6% | – | 4.1% |
| Other assets | – | 24,157 | – | – | – | – | 158,113 | 182,270 |
| **Total** | $ 82,211 | $ 1,860,730 | $ 427,368 | $ 2,027,101 | $ 4,589,394 | $ 6,343,945 | $ 188,069 | $15,518,818 |
| **Weighted-average interest rate** | 1.0% | 4.2% | 6.2% | 5.4% | 5.3% | 3.9% | – | 4.6% |
| **Liabilities and shareholders' equity** | | | | | | | | |
| Deposits payable on demand | $ 6 | $ – | $ – | $ – | $ – | $ – | $ 50,353 | $ 50,359 |
| Deposits payable at a fixed rate | – | 469,248 | 935,879 | 2,048,885 | 2,441,726 | 637,744 | 12,138 | 6,545,620 |
| Weighted-average interest rate | – | 2.6% | 2.4% | 2.3% | 3.3% | 3.6% | – | 2.8% |
| Securitization liabilities | – | – | – | 337,075 | 2,400,600 | 5,366,903 | – | 8,104,578 |
| Weighted-average interest rate | – | – | – | 3.5% | 3.2% | 2.7% | – | 2.9% |
| Other liabilities | – | 9,009 | – | – | – | – | 180,667 | 189,676 |
| Shareholders' equity | – | – | – | – | – | – | 628,585 | 628,585 |
| **Total** | $ 6 | $ 478,257 | $ 935,879 | $ 2,385,960 | $ 4,842,326 | $ 6,004,647 | $ 871,743 | $15,518,818 |
| **Weighted-average interest rate** | – | 2.6% | 2.4% | 2.5% | 3.3% | 2.8% | – | 2.7% |
| | $ 82,205 | $ 1,382,473 | $ (508,511) | $ (358,859) | $ (252,932) | $ 339,298 | $ (683,674) | $ – |
| Credit commitments | – | (411,112) | 7,216 | 9,193 | 179,836 | 214,867 | – | – |
| Weighted-average interest rate | – | 4.4% | 9.4% | 5.8% | 5.2% | 3.5% | – | – |
| **Interest rate sensitivity gap** | $ 82,205 | $ 971,361 | $ (501,295) | $ (349,666) | $ (73,096) | $ 554,165 | $ (683,674) | $ – |
| **Cumulative gap** | $ 82,205 | $ 1,053,566 | $ 552,271 | $ 202,605 | $ 129,509 | $ 683,674 | $ – | $ – |
| **Cumulative gap as a percentage of total assets** | 0.5% | 6.8% | 3.6% | 1.3% | 0.8% | 4.4% | – | – |

As at January 1, 2010

| (thousands of Canadian dollars, except %) | Floating | 0 to 3 Months | 3 to 6 Months | 6 to 12 Months | 1 to 3 Years | Over 3 Years | Non-interest Sensitive | Total |
|---|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | | |
| Cash resources | $ 68,941 | $ 815,093 | $ – | $ 46,100 | $ – | $ – | $ – | $ 930,134 |
| Weighted-average interest rate | 3.0% | 0.3% | – | 0.5% | – | – | – | 0.3% |
| Securities | – | 19,323 | 133,613 | 69,788 | 187,095 | 184,721 | – | 594,540 |
| Weighted-average interest rate | – | 3.6% | 1.4% | 2.2% | 2.5% | 5.7% | – | 3.2% |
| Non-securitized mortgages and loans | – | 1,511,601 | 341,894 | 721,695 | 1,889,594 | 980,828 | 51,193 | 5,496,805 |
| Weighted-average interest rate | – | 5.5% | 7.5% | 6.3% | 6.2% | 6.0% | – | 6.0% |
| Securitized residential mortgages | – | 84,310 | 9,430 | 331,173 | 777,134 | 2,924,660 | – | 4,126,707 |
| Weighted-average interest rate | – | 6.4% | 5.9% | 6.4% | 6.2% | 4.7% | – | 5.2% |
| Other assets | – | 13,186 | – | – | – | – | 129,214 | 142,400 |
| **Total** | $ 68,941 | $ 2,443,513 | $ 484,937 | $ 1,168,756 | $ 2,853,823 | $ 4,090,209 | $ 180,407 | $11,290,586 |
| **Weighted-average interest rate** | 0.3% | 3.8% | 5.8% | 5.9% | 6.0% | 5.1% | – | 5.0% |
| **Liabilities and shareholders' equity** | | | | | | | | |
| Deposits payable on demand | $ 6 | $ – | $ – | $ – | $ – | $ – | $ 38,217 | $ 38,223 |
| Deposits payable at a fixed rate | – | 576,250 | 640,899 | 2,150,033 | 2,265,806 | 788,636 | 11,909 | 6,433,533 |
| Weighted-average interest rate | – | 3.0% | 2.7% | 2.3% | 3.4% | 3.8% | – | 3.0% |
| Securitization liabilities | – | – | – | 320,597 | 820,723 | 3,015,136 | – | 4,156,456 |
| Weighted-average interest rate | – | – | – | 3.8% | 4.3% | 3.2% | – | 3.5% |
| Other liabilities | – | 11,099 | – | – | – | – | 147,652 | 158,751 |
| Shareholders' equity | – | – | – | – | – | – | 503,623 | 503,623 |
| **Total** | $ 6 | $ 587,349 | $ 640,899 | $ 2,470,630 | $ 3,086,529 | $ 3,803,772 | $ 701,401 | $11,290,586 |
| **Weighted-average interest rate** | – | 2.9% | 2.7% | 2.5% | 3.6% | 3.3% | – | 3.0% |
| | $ 68,935 | $ 1,856,164 | $ (155,962) | $(1,301,874) | $ (232,706) | $ 286,437 | $ (520,994) | $ – |
| Credit commitments | – | (307,364) | 70,977 | 29,137 | 207,250 | – | – | – |
| Weighted-average interest rate | – | 3.7% | 4.1% | 7.0% | 4.8% | – | – | – |
| **Interest rate sensitivity gap** | $ 68,935 | $ 1,548,800 | $ (84,985) | $(1,272,737) | $ (25,456) | $ 286,437 | $ (520,994) | $ – |
| **Cumulative gap** | $ 68,935 | $ 1,617,735 | $ 1,532,750 | $ 260,013 | $ 234,557 | $ 520,994 | $ – | $ – |
| **Cumulative gap as a percentage of total assets** | 0.6% | 14.3% | 13.6% | 2.3% | 2.1% | 4.6% | – | – |

## NOTE 22 FAIR VALUE OF FINANCIAL INSTRUMENTS

The amounts set out in the following table represent the fair values of the Company's financial instruments, both on- and off-balance sheet. The valuation methods and assumptions are described below.

The estimated fair value amounts approximate amounts at which financial instruments could be exchanged in a current transaction between willing parties that are under no compulsion to act. For financial instruments that lack an available trading market, the Company applies present value and valuation techniques that use observable or unobservable market inputs. 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.

| | **As at December 31, 2011** | | | As at December 31, 2010 | | |
|---|---|---|---|---|---|---|
| (thousands of Canadian dollars) | **Carrying Value** | **Fair Value** | **Fair Value Over (Under) Carrying Value** | Carrying Value | Fair Value | Fair Value Over (Under) Carrying Value |
| **Assets** | | | | | | |
| Cash resources | **$ 665,806** | **$ 665,806** | **$ –** | $ 846,824 | $ 846,824 | $ – |
| Securities | **733,342** | **733,342** | **–** | 427,122 | 427,122 | – |
| Non-securitized mortgages and loans | **7,816,858** | **7,976,732** | **159,874** | 5,945,966 | 6,103,055 | 157,089 |
| Securitized residential mortgages | **8,243,350** | **8,908,502** | **665,152** | 8,116,636 | 8,557,907 | 441,271 |
| Derivative assets | **72,424** | **72,424** | **–** | 24,157 | 24,157 | – |
| Other | **164,691** | **164,691** | **–** | 158,113 | 158,113 | – |
| **Liabilities** | | | | | | |
| Deposits | **7,922,124** | **8,128,223** | **206,099** | 6,595,979 | 6,624,655 | 28,676 |
| Senior debt | **153,336** | **156,615** | **3,279** | – | – | – |
| Securitization liabilities | **8,649,075** | **8,585,033** | **(64,042)** | 8,104,578 | 7,937,172 | (167,406) |
| Derivative liabilities | **3,458** | **3,458** | **–** | 9,009 | 9,009 | – |
| Other | **193,693** | **193,693** | **–** | 180,667 | 180,667 | – |

| | As at January 1, 2010 | | |
|---|---|---|---|
| (thousands of Canadian dollars) | Carrying Value | Fair Value | Fair Value Over (Under) Carrying Value |
| **Assets** | | | |
| Cash resources | $ 930,134 | $ 930,134 | $ – |
| Securities | 594,540 | 594,540 | – |
| Non-securitized mortgages and loans | 5,496,805 | 5,683,258 | 186,453 |
| Securitized residential mortgages | 4,126,707 | 4,454,779 | 328,072 |
| Derivative assets | 13,186 | 13,186 | – |
| Other | 129,214 | 129,214 | – |
| **Liabilities** | | | |
| Deposits | 6,471,756 | 6,560,435 | 88,679 |
| Securitization liabilities | 4,156,456 | 4,232,850 | 76,394 |
| Derivative liabilities | 11,099 | 11,099 | – |
| Other | 147,652 | 147,652 | – |

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

> Cash resources are assumed to approximate their carrying values due to their short-term nature. The fair value of treasury bills is determined using rates from the Bank of Canada.

> Securities are valued based on the quoted bid price as provided in Note 4.

> Fair value of loans is determined by discounting the expected future cash flows of the loans at market rates for loans with similar terms and credit risks.

> Other assets are assumed to approximate their carrying values due to their short-term nature.

> Fair value of deposits payable on demand approximates their carrying value; fixed-rate deposits are determined by discounting the contractual cash flows using the market interest rates currently offered for deposits with similar terms and risks.

> Fair value of senior debt is based on quoted bid price.

> Fair value of securitization liabilities is determined by reference to the quoted price of the liability in the market.

> Other liabilities are assumed to approximate their carrying values due to their short-term nature.

> Fair value of credit commitments is determined by discounting the expected future cash flows of the credit commitments at market rates for loans with similar terms and credit risks. Carrying value amount represents the notional amount of the commitments. Fair value amount represents the original notional amount adjusted for changes in fair value.

> Fair value of derivative financial instruments is calculated as described in Note 19.

The Company uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

Level 1: Quoted (Unadjusted) Prices in Active Markets for Identical Assets or Liabilities: This level of hierarchy includes equity securities traded on the Toronto Stock Exchange and quoted corporate and government-backed debt instruments.

Level 2: Valuation Techniques with Observable Parameters: This level of hierarchy includes loans, commitments, interest rate swaps and bond forwards and certain corporate debt instruments.

Level 3: Valuation Techniques with Significant Unobservable Parameters: Instruments classified in this category have a parameter input or inputs that are unobservable and have more than insignificant impact on either the fair value of the instrument or the profit or loss of the instrument. The Company did not have any Level 3 financial instruments in 2011 or 2010.

The following table presents the carrying value of financial instruments held at fair value across the levels of the fair value hierarchy.

| | | As at December 31, 2011 | |
|---|---|---|---|
| (thousands of Canadian dollars) | Level 1 | Level 2 | Total |
| **Financial assets held for trading** | | | |
| Interest rate swaps (hedge swaps) | $ – | $ 72,424 | $ 72,424 |
| **Financial instruments available for sale** | | | |
| Securities issued or guaranteed by | | | |
| Canada | 5,196 | – | 5,196 |
| Corporations | – | 8,060 | 8,060 |
| Equity securities | | | |
| Common | 8,851 | – | 8,851 |
| Fixed rate preferred | 368,473 | – | 368,473 |
| Mutual funds | – | 1,174 | 1,174 |
| Pledged securities | 319,981 | 21,607 | 341,588 |
| **Total** | $ 702,501 | $ 103,265 | $ 805,766 |
| **Financial liabilities at fair value** | | | |
| Interest rate swaps | $ – | $ 3,458 | $ 3,458 |
| **Total** | $ – | $ 3,458 | $ 3,458 |

| | | | As at December 31, 2010 |
|---|---|---|---|
| (thousands of Canadian dollars) | Level 1 | Level 2 | Total |
| **Financial assets held for trading** | | | |
| Interest rate swaps (hedge swaps) | $ – | $ 24,157 | $ 24,157 |
| **Financial instruments available for sale** | | | |
| Securities issued or guaranteed by | | | |
| Canada | 4,981 | – | 4,981 |
| Corporations | 96,652 | – | 96,652 |
| Equity securities | | | |
| Common | 7,362 | – | 7,362 |
| Fixed rate preferred | 309,331 | – | 309,331 |
| Income trusts | 4,727 | – | 4,727 |
| Mutual funds | – | 1,115 | 1,115 |
| Pledged securities | – | 2,954 | 2,954 |
| **Total** | $ 423,053 | $ 28,226 | $ 451,279 |
| **Financial liabilities at fair value** | | | |
| Interest rate swaps | $ – | $ 9,009 | $ 9,009 |
| **Total** | $ – | $ 9,009 | $ 9,009 |

| | | | As at January 1, 2010 |
|---|---|---|---|
| (thousands of Canadian dollars) | Level 1 | Level 2 | Total |
| **Financial assets held for trading** | | | |
| Bond forward contracts | $ – | $ 13,186 | $ 13,186 |
| Securities issued or guaranteed by Canada | 99,938 | – | 99,938 |
| **Financial instruments available for sale** | | | |
| Securities issued or guaranteed by corporations | 194,085 | – | 194,085 |
| Equity securities | | | |
| Common | 6,805 | – | 6,805 |
| Fixed rate preferred | 287,967 | – | 287,967 |
| Income trusts | 4,800 | – | 4,800 |
| Mutual funds | – | 945 | 945 |
| **Total** | $ 593,595 | $ 14,131 | $ 607,726 |
| **Financial liabilities at fair value** | | | |
| Interest rate swaps | $ – | $ 11,099 | $ 11,099 |
| **Total** | $ – | $ 11,099 | $ 11,099 |

As at December 31, 2011, December 31, 2010 and January 1, 2010, the Company did not have any Level 3 financial instruments nor did the Company transfer any financial instrument from Level 1 or Level 2 to Level 3 of the fair value hierarchy during 2011 or 2010.

## NOTE 23 EARNINGS BY BUSINESS SEGMENT

The Company operates principally through two segments – mortgage lending and consumer lending. The mortgage lending segment consists of mortgage lending, securitization of insured mortgage loans and secured loans. The consumer lending segment consists of credit cards, PSiGate and individual loans to customers of retail businesses. These operating segments are supported by other activities including treasury and security investments and general corporate activities.

The following table details the earnings of the Company by business segment.

| 2011 (thousands of Canadian dollars) | Mortgage Lending | Consumer Lending | Other | Total |
|---|---|---|---|---|
| Net interest income | $ 273,738 | $ 41,782 | $ 18,432 | $ 333,952 |
| Provision for credit losses | (5,916) | (1,603) | – | (7,519) |
| Fees and other income | 19,457 | 18,051 | 489 | 37,997 |
| Net (loss) gain on securities and others | (4,821) | – | 1,706 | (3,115) |
| Non-interest expenses | (67,851) | (16,255) | (20,896) | (105,002) |
| Income before income taxes | 214,607 | 41,975 | (269) | 256,313 |
| Income taxes | (59,331) | (11,872) | 4,970 | (66,233) |
| Net income | $ 155,276 | $ 30,103 | $ 4,701 | $ 190,080 |
| Goodwill | $ 2,324 | $ 13,428 | $ – | $ 15,752 |
| Total assets | $ 15,997,106 | $ 614,626 | $ 1,084,739 | $ 17,696,471 |

| 2010 (thousands of Canadian dollars) | Mortgage Lending | Consumer Lending | Other | Total |
|---|---|---|---|---|
| Net interest income | $ 202,745 | $ 35,761 | $ 25,524 | $ 264,030 |
| Provision for credit losses | (5,304) | (4,127) | – | (9,431) |
| Fees and other income | 15,243 | 15,229 | 218 | 30,690 |
| Net gain on securities and others | 10,608 | 3,917 | 8,953 | 23,478 |
| Non-interest expenses | (61,114) | (14,945) | (19,417) | (95,476) |
| Income before income taxes | 162,178 | 35,835 | 15,278 | 213,291 |
| Income taxes | (47,676) | (11,129) | 266 | (58,539) |
| Net income | $ 114,502 | $ 24,706 | $ 15,544 | $ 154,752 |
| Goodwill | $ 2,324 | $ 13,428 | $ – | $ 15,752 |
| Total assets | $ 13,797,202 | $ 514,872 | $ 1,206,744 | $ 15,518,818 |

## NOTE 24 RELATED PARTY TRANSACTIONS

Compensation of key management personnel of the Company is as follows:

| (thousands of Canadian dollars) | 2011 | 2010 |
|---|---|---|
| Short-term employee benefits | $ 6,969 | $ 4,670 |
| Other long-term benefits | 154 | 72 |
| Share-based payment | 503 | 1,437 |
| | $ 7,626 | $ 6,179 |

## NOTE 25 RISK MANAGEMENT

The Company is exposed to various types of risk owing to the nature of the business activities it carries on. Types of risk to which the Company is subject include credit, liquidity, interest rate and other price risks. The Company has adopted enterprise risk management (ERM) as a discipline for managing risk. The Company's ERM structure is supported by a governance framework that includes policies, management standards, guidelines and procedures appropriate to each business activity. The policies are reviewed and approved annually by the Board of Directors.

A description of the Company's risk management policies and procedures is included in the shaded text of the Risk Management section of the MD&A. Significant exposures to credit, liquidity and interest rate risks are described in Notes 4, 5, 19 and 21.

## NOTE 26 TRANSITION TO IFRS

The Company has adopted IFRS effective January 1, 2011. Prior to the adoption of IFRS, the Company prepared its consolidated financial statements in accordance with the previous Canadian GAAP. These consolidated financial statements of the Company represent the first annual financial statements that comply with IFRS. The Company's transition date is January 1, 2010 (the transition date) and the Company has prepared its opening consolidated balance sheet at that date. These consolidated financial statements have been prepared in accordance with the accounting policies described in Note 2.

In preparing these consolidated financial statements, the Company has applied the requirements of IFRS 1. IFRS 1 requires first-time adopters to retrospectively apply all effective IFRS as of the first annual reporting date which, for the Company, is December 31, 2011. However, IFRS 1 provides for certain optional exemptions and certain mandatory exemptions from full retrospective application of IFRS. The optional exemptions and mandatory exemptions applied by the Company are described below.

### (a) Elected Exemptions from Full Retrospective Application

#### *(i) Business Combinations*

The Company elected to apply the business combinations exemption in IFRS 1 and did not apply IFRS 3 *Business Combinations* retrospectively to past business combinations. Accordingly, the Company has not restated business combinations that took place prior to the transition date to IFRS and the carrying amount of goodwill under IFRS at the transition date is equal to the carrying amount under Canadian GAAP at that date.

#### *(ii) Share-based Payment Transactions*

The Company elected to apply IFRS 2 *Share-based Payment* (IFRS 2) to equity instruments granted after November 7, 2002 that had not vested by the transition date. Accordingly, the Company has only applied IFRS 2 to grants of employee stock options that were granted after November 7, 2002 that remain unvested as at January 1, 2010.

#### *(iii) Borrowing Costs*

The Company elected to apply IAS 23 *Borrowing Costs* to borrowing costs relating to qualifying assets for which the commencement date for capitalization is on or after the transition date to IFRS.

#### *(iv) Leases*

The Company elected to determine whether an arrangement existing at the date of transition contains a lease on the basis of facts and circumstances existing at the transition date.

### (b) Mandatory Exemptions from Full Retrospective Application

#### *(i) Derecognition of Financial Assets and Financial Liabilities*

Although recent amendments to IFRS 1 permit the Company to apply the derecognition requirements of IAS 39 *Financial Instruments: Recognition and Measurement* prospectively from January 1, 2010, the Company chose to apply the standards retroactively as directed by OSFI.

#### *(ii) Hedge Accounting*

Hedge accounting cannot be reflected in the opening IFRS balance sheet if it does not qualify for hedge accounting under IFRS nor be applied retrospectively to transactions entered into prior to the transition to IFRS. Accordingly, the Company only applied hedge accounting to transactions that qualified for hedge accounting after the date of transition to IFRS. The Company did not apply hedge accounting under Canadian GAAP.

#### *(iii) Estimates*

Hindsight cannot be used to create or revise estimates and accordingly the estimates previously made by the Company under Canadian GAAP were not revised for application of IFRS except where necessary to reflect any difference in accounting policies.

### (c) Reconciliations of Canadian GAAP to IFRS

The Company is required under IFRS 1 to provide the following reconciliations from previous Canadian GAAP to IFRS for its shareholders' equity and comprehensive income.

#### Reconciliation of Shareholders' Equity

| (thousands of Canadian dollars) | Note | As at December 31, 2010 | As at January 1, 2010 |
|---|---|---|---|
| Shareholders' equity reported under previous Canadian GAAP | | $ 742,280 | $ 590,288 |
| Differences increasing (decreasing) reported shareholders' equity: | | | |
| Securitization of mortgages | (i) | (163,583) | (135,121) |
| Hedge ineffectiveness | (ii) | 682 | – |
| Interest on non-performing loans | (iv) | 1,203 | 1,646 |
| Provision for accrued interest on non-performing loans | (v) | (405) | (385) |
| Deferred income taxes | (vii) | 48,408 | 47,195 |
| Shareholders' equity reported under IFRS | | $ 628,585 | $ 503,623 |

#### Reconciliation of Net Income

| (thousands of Canadian dollars) | Note | Year Ended December 31, 2010 |
|---|---|---|
| Net income reported under previous Canadian GAAP | | $ 180,944 |
| Differences increasing (decreasing) reported net income: | | |
| Securitization of mortgages | (i) | (28,962) |
| Hedge ineffectiveness | (ii) | 682 |
| Impairment of available for sale securities | (iii) | 739 |
| Interest on non-performing loans | (iv) | (443) |
| Provision for accrued interest on non-performing loans | (v) | (20) |
| Share-based compensation expense | (vi) | (922) |
| Deferred income taxes | (vii) | 2,734 |
| Net income reported under IFRS | | $ 154,752 |

#### Reconciliation of Comprehensive Income

| (thousands of Canadian dollars) | Note | Year Ended December 31, 2010 |
|---|---|---|
| Comprehensive income reported under previous Canadian GAAP | | $ 178,405 |
| Differences increasing (decreasing) reported comprehensive income: | | |
| Differences in net income | | (26,192) |
| Securitization of mortgages | (i) | 500 |
| Impairment of available for sale securities | (iii) | (739) |
| Deferred income taxes | (vii) | (1,521) |
| Comprehensive income reported under IFRS | | $ 150,453 |

### Notes to Above Reconciliations

***(i) Securitization of Mortgages***

The Company periodically transfers pools of mortgages to CMHC-sponsored SPEs or trusts which, in turn, issue securities to investors.

Under previous Canadian GAAP, these transfers were accounted for as sales when the Company surrendered control of the transferred assets and received consideration other than the beneficial interest in the transferred assets. When such sales occur, the Company retains interest-only strips and servicing responsibilities for the assets sold. Gains or losses on these transactions were recognized as income. The gains or losses recorded were dependent in part on the previous carrying amount of the financial assets involved in the transfer, allocated between the assets sold and the retained interests based on their relative fair value at the date of transfer, net of transaction costs. Retained interests were classified as available for sale assets and were stated at their fair value at the date of transfer with unrealized gains and losses reported in AOCI. The servicing liabilities were included with other liabilities and stated originally at their fair value and amortized into income over the period of the mortgage pool. As part of the securitization program, the Company entered into certain interest rate swaps. These transactions did not qualify for hedge accounting and therefore were accounted for on a mark-to-market basis, with changes in the fair value of the swap being recognized in income.

Under IFRS, the above securitization transactions do not qualify for treatment as sales of mortgages and instead are treated as secured borrowing transactions. Consequently, the securitized mortgages are accounted for in the same manner as non-securitized mortgages, remaining on the consolidated balance sheets with interest income recognized in the consolidated statements of income. In addition, an obligation to repay the funding received in the securitization transaction is recognized on the consolidated balance sheets as secured borrowing (securitization liabilities) and related interest expense is recognized in the consolidated statements of income.

The difference in accounting treatment between previous Canadian GAAP and IFRS for these securitization transactions has resulted in the following adjustments to the Company's consolidated financial statements:

> Securitized mortgages that were off-balance sheet under previous Canadian GAAP have been recognized in the consolidated balance sheets under IFRS.

> Securitization liabilities not previously recognized under previous Canadian GAAP have been recognized in the consolidated balance sheets under IFRS.

> Securitization receivables related to retained interests recognized on the consolidated balance sheets under previous Canadian GAAP have been removed from the consolidated balance sheets under IFRS.

> Securitization servicing liability included in other liabilities on the consolidated balance sheets under previous Canadian GAAP has been removed from the consolidated balance sheets under IFRS.

> Home Trust MBS held by the Company but not yet sold to third parties or used as replacement assets in the CMB program were reclassified to securitized mortgages from available for sale securities. Unrealized fair value gains or losses recognized in AOCI were reversed under IFRS .

> Gains and losses on securitization previously recognized in net income under previous Canadian GAAP have been reversed under IFRS.

> Interest income earned on the securitized mortgages not previously recognized under previous Canadian GAAP has been recognized in net income under IFRS.

> Interest expense on the securitization liabilities not previously recognized under previous Canadian GAAP has been recognized in net income under IFRS.

> Unrealized gains and losses on retained interests recognized in OCI under previous Canadian GAAP has been reversed under IFRS.

> Amortization of servicing liability recognized in net income under previous Canadian GAAP has been reversed under IFRS.

> Certain transaction costs that formed part of the gain or loss on securitization under previous Canadian GAAP have been capitalized and recognized in interest income and expense under IFRS through the use of the effective interest rate method.

> Gains and losses on the interest rate swaps (seller swaps) that were recognized in net income under previous Canadian GAAP were reversed under IFRS as the cash flows associated with these swaps are captured in the interest income recognized on the securitized mortgages and the interest expense recognized on the secured debt under IFRS.

The above adjustments related to securitization transactions occurring before the date of transition have been adjusted through retained earnings or AOCI in the consolidated balance sheet as at January 1, 2010. The adjustments related to securitization transactions occurring on or after the date of transition and up to December 31, 2010 have been reflected in the consolidated statement of comprehensive income for the year ended December 31, 2010 and through retained earnings and AOCI on the consolidated balance sheet as at December 31, 2010.

The overall impact of the difference in accounting treatment between previous Canadian GAAP and IFRS for these securitization transactions results in differences as to the timing of the recognition of the cash flows in total comprehensive income. Ultimately, at the end of the life of each securitization pool, the same cumulative total amount of income will have been recognized in shareholders' equity under both previous Canadian GAAP and IFRS.

*(ii) Hedging*

In the latter part of 2010, the Company designated certain derivative instruments used to hedge interest rate risk in hedge accounting relationships under IFRS that did not qualify for hedge accounting under previous Canadian GAAP. Accordingly, certain gains and losses recognized in net income under previous Canadian GAAP have been accounted for as fair value hedges under IFRS, where only the ineffective portion of the hedges are recorded in net income.

*(iii) Impairment of Equity Investments*

Under IFRS, a significant or prolonged decline in the fair value of an investment in an equity investment below its cost is considered objective evidence of impairment, resulting in the recognition of an impairment loss. Under previous Canadian GAAP, such significant or prolonged declines were considered as an indicator of impairment, but not a definitive factor. The Company has recognized impairment losses as at January 1, 2010 and during 2010 under IFRS on certain equity investments with significant or prolonged declines in fair value below cost that were not considered impaired under previous Canadian GAAP. Additionally, impairment losses on certain equity investments were recognized under previous Canadian GAAP during 2010 that would have been recognized prior to 2010 under IFRS and consequently recognized as at January 1, 2010 under IFRS. Accordingly, adjustments from previous Canadian GAAP to IFRS were made between retained earnings and AOCI as at January 1, 2010 and between net income and OCI during 2010. These adjustments did not affect total shareholders' equity.

*(iv) Accrued Interest on Non-performing Loans*

Under previous Canadian GAAP, when a loan becomes non-performing, the accrual of interest ceases. Interest that is subsequently recovered is recognized at the time of recovery. Under IFRS, interest on non-performing loans continues to be accrued. Accordingly, an adjustment from previous Canadian GAAP to IFRS has been made to retained earnings as at January 1, 2010 to reflect accrued interest on non-performing loans up to the date of transition. Interest on non-performing loans subsequent to the date of transition has been recognized in net income in the relevant period.

*(v) Allowance for Accrued Interest on Non-performing Loans*

As a result of recognizing accrued interest on non-performing loans under IFRS as described above, the carrying amount of accrued interest receivable related to these non-performing loans recognized in the consolidated balance sheets has increased. Consequently, an allowance against the accrued interest receivable on these non-performing loans has been established where the Company does not expect to recover all of the accrued interest. Changes to this allowance are recognized in the provision for credit losses in the consolidated statements of income.

*(vi) Share-based Compensation*

Under previous Canadian GAAP, the Company accounted for stock option grants with graded vesting as one award, recognizing as expense the total fair value on a straight-line basis over the vesting period. Under IFRS, the Company is required to account for each tranche in an award with graded vesting as a separate grant with a different vesting period and fair value. As a result, the Company adjusted its expense for these share-based awards to reflect this difference in recognition.

Under previous Canadian GAAP, the Company had the option of recognizing forfeitures as they occur or making an estimate of forfeitures. The Company utilized both options under previous Canadian GAAP based on when the award was granted. Under IFRS, the Company makes an estimate of forfeitures for all awards. As a result, the Company adjusted its expense for these share-based awards to reflect this difference in recognition.

The above adjustments resulted in differences between previous Canadian GAAP and IFRS for the amount of expense recognized in net income. However, as these differences only result in a reclassification between retained earnings and contributed surplus on the consolidated balance sheets, there was no resulting difference in total shareholders' equity.

*(vii) Income Taxes*

The adjustments for income taxes reflect the impact of the other IFRS adjustments described above. The portion of the adjustments to income taxes payable or recoverable that is related to items recorded through OCI does not affect net income.

### Financial Statement Reconciliations

The following reconciliations demonstrate the impact of the above noted IFRS transition adjustments to the consolidated balance sheet and the consolidated statements of income, comprehensive income and cash flows.

### Reconciliation of Consolidated Balance Sheet

(thousands of Canadian dollars) As at December 31, 2010

| Previous Canadian GAAP Line Items | Canadian GAAP Balance | IFRS Adjustments | IFRS Reclassification | IFRS Balance | IFRS Line Items |
|---|---|---|---|---|---|
| ASSETS | | | | | ASSETS |
| Cash resources | $ 846,824 | $ – | $ – | $ 846,824 | Cash resources |
| Securities | | | | | Securities |
| Available for sale | 543,892 | (119,724) | – | 424,168 | Available for sale |
| | – | 2,954 | – | 2,954 | Pledged securities |
| | 543,892 | (116,770) | – | 427,122 | |
| Loans | | | | | Loans |
| Residential mortgages | 4,570,130 | 113,397 | – | 4,683,527 | Residential mortgages |
| | – | 8,116,636 | – | 8,116,636 | Securitized residential mortgages |
| Non-residential mortgages | 838,253 | – | – | 838,253 | Non-residential mortgages |
| Personal and credit card loans | 453,339 | – | – | 453,339 | Personal and credit card loans |
| | 5,861,722 | 8,230,033 | – | 14,091,755 | |
| General allowance for credit losses | (29,153) | – | – | (29,153) | Collective allowance for credit losses |
| | 5,832,569 | 8,230,033 | – | 14,062,602 | |
| Other | | | | | Other |
| Securitization receivable | 343,402 | (343,402) | – | – | |
| | – | – | 9,451 | 9,451 | Income taxes receivable |
| | – | 24,157 | – | 24,157 | Derivative assets |
| Other assets | 140,658 | 12,561 | (73,120) | 80,099 | Other assets |
| Capital assets | 4,894 | – | – | 4,894 | Capital assets |
| | – | – | 47,917 | 47,917 | Intangible assets |
| | – | – | 15,752 | 15,752 | Goodwill |
| | 488,954 | (306,684) | – | 182,270 | |
| | $ 7,712,239 | $ 7,806,579 | $ – | $ 15,518,818 | |

### Reconciliation of Consolidated Balance Sheet

(thousands of Canadian dollars) As at December 31, 2010

| Previous Canadian GAAP Line Items | Canadian GAAP Balance | IFRS Adjustments | IFRS Reclassification | IFRS Balance | IFRS Line Items |
|---|---|---|---|---|---|
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | | | LIABILITIES AND SHAREHOLDERS' EQUITY |
| Liabilities | | | | | Liabilities |
| Deposits | | | | | Deposits |
| Payable on demand | $ 50,359 | $ – | $ – | $ 50,359 | Payable on demand |
| Payable on a fixed date | 6,545,620 | – | – | 6,545,620 | Payable on a fixed date |
| | 6,595,979 | – | – | 6,595,979 | |
| | | | | | Securitization Liabilities |
| | – | 2,826,105 | – | 2,826,105 | Mortgage-backed security liabilities |
| | – | 5,278,473 | – | 5,278,473 | Canada Mortgage Bond liabilities |
| | – | 8,104,578 | – | 8,104,578 | |
| Other | | | | | Other |
| | – | 9,009 | – | 9,009 | Derivative liabilities |
| Other liabilities | 373,980 | (144,864) | (88,562) | 140,554 | Other liabilities |
| | – | (48,449) | 88,562 | 40,113 | Deferred tax liabilities |
| | 373,980 | (184,304) | – | 189,676 | |
| | 6,969,959 | 7,920,274 | – | 14,890,233 | |
| Shareholders' equity | | | | | Shareholders' Equity |
| Capital stock | 50,427 | – | – | 50,427 | Capital stock |
| Contributed surplus | 3,649 | 922 | – | 4,571 | Contributed surplus |
| Retained earnings | 669,475 | (101,794) | – | 567,681 | Retained earnings |
| Accumulated other comprehensive income | 18,729 | (12,823) | – | 5,906 | Accumulated other comprehensive loss |
| | 742,280 | (113,695) | – | 628,585 | |
| | $ 7,712,239 | $ 7,806,579 | $ – | $ 15,518,818 | |

Certain amounts presented above under the previous Canadian GAAP balance have been reclassified from what was presented in the 2010 consolidated financial statements to conform to the presentation of the 2011 consolidated financial statements. This change in presentation is not part of the transition to IFRS.

## Reconciliation of Consolidated Balance Sheet

(thousands of Canadian dollars) As at January 1, 2010

| Previous Canadian GAAP Line Items | Canadian GAAP Balance | IFRS Adjustments | IFRS Reclassification | IFRS Balance | IFRS Line Items |
|---|---|---|---|---|---|
| ASSETS | | | | | ASSETS |
| Cash resources | $ 930,134 | $ – | $ – | $ 930,134 | Cash resources |
| Securities | | | | | Securities |
| Held for trading | 99,938 | – | – | 99,938 | Held for trading |
| Available for sale | 550,659 | (56,057) | – | 494,602 | Available for sale |
| | 650,597 | (56,057) | – | 594,540 | |
| Loans | | | | | Loans |
| Residential mortgages | 4,417,197 | 56,058 | – | 4,473,255 | Residential mortgages |
| | – | 4,126,707 | – | 4,126,707 | Securitized residential mortgages |
| Non-residential mortgages | 708,425 | – | – | 708,425 | Non-residential mortgages |
| Personal and credit card loans | 342,918 | – | – | 342,918 | Personal and credit card loans |
| | 5,468,540 | 4,182,765 | – | 9,651,305 | |
| General allowance for credit losses | (27,793) | – | – | (27,793) | Collective allowance for credit losses |
| | 5,440,747 | 4,182,765 | – | 9,623,512 | |
| Other | | | | | Other |
| Securitization receivable | 229,418 | (229,418) | – | – | |
| | – | 6,466 | – | 6,466 | Income taxes receivable |
| | – | 13,186 | – | 13,186 | Derivative assets |
| Other assets | 105,115 | 12,770 | (42,563) | 75,322 | Other assets |
| Capital assets | 4,863 | – | – | 4,863 | Capital assets |
| | – | – | 26,811 | 26,811 | Intangible assets |
| | – | – | 15,752 | 15,752 | Goodwill |
| | 339,396 | (196,996) | – | 142,400 | |
| | $ 7,360,874 | $ 3,929,712 | $ – | $ 11,290,586 | |

### Reconciliation of Consolidated Balance Sheet

(thousands of Canadian dollars) As at January 1, 2010

| Previous Canadian GAAP Line Items | Canadian GAAP Balance | IFRS Adjustments | IFRS Reclassification | IFRS Balance | IFRS Line Items |
|---|---|---|---|---|---|
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | | | LIABILITIES AND SHAREHOLDERS' EQUITY |
| Liabilities | | | | | Liabilities |
| Deposits | | | | | Deposits |
| Payable on demand | $ 38,223 | $ – | $ – | $ 38,223 | Payable on demand |
| Payable on a fixed date | 6,433,533 | – | – | 6,433,533 | Payable on a fixed date |
| | 6,471,756 | – | – | 6,471,756 | |
| | | | | | Securitization Liabilities |
| | – | 1,191,552 | – | 1,191,552 | Mortgage-backed security liabilities |
| | – | 2,964,904 | – | 2,964,904 | Canada Mortgage Bond liabilities |
| | – | 4,156,456 | – | 4,156,456 | |
| Other | | | | | Other |
| | – | 11,099 | – | 11,099 | Derivative liabilities |
| Other liabilities | 298,830 | (110,448) | (57,559) | 130,823 | Other liabilities |
| | – | (40,730) | 57,559 | 16,829 | Deferred tax liabilities |
| | 298,830 | (140,079) | – | 158,751 | |
| | 6,770,586 | 4,016,377 | – | 10,786,963 | |
| Shareholders' equity | | | | | Shareholders' Equity |
| Capital stock | 45,396 | – | – | 45,396 | Capital stock |
| Contributed surplus | 3,606 | – | – | 3,606 | Contributed surplus |
| Retained earnings | 520,018 | (75,602) | – | 444,416 | Retained earnings |
| Accumulated other comprehensive income | 21,268 | (11,063) | – | 10,205 | Accumulated other comprehensive loss |
| | 590,288 | (86,665) | – | 503,623 | |
| | $ 7,360,874 | $ 3,929,712 | $ – | $ 11,290,586 | |

Certain amounts presented above under the previous Canadian GAAP balance have been reclassified from what was presented in the 2010 consolidated financial statements to conform to the presentation of the 2011 consolidated financial statements. This change in presentation is not part of the transition to IFRS.

**Reconciliation of Consolidated Statement of Income**

(thousands of Canadian dollars, except per share amounts) For the Year Ended December 31, 2010

| Previous Canadian GAAP Line Items | Canadian GAAP Balance | IFRS Adjustments | IFRS Balance | IFRS Line Items |
|---|---|---|---|---|
| Income | | | | Net Interest Income Non-Securitized Assets |
| Interest from loans | $ 354,222 | $ (443) | $ 353,779 | Interest from loans |
| Dividends from securities | 18,204 | – | 18,204 | Dividends from securities |
| Other interest | 9,806 | – | 9,806 | Other interest |
| | 382,232 | (443) | 381,789 | |
| Interest on deposits | 188,370 | – | 188,370 | Interest on deposits |
| Net interest income | 193,862 | (443) | 193,419 | Net interest income non-securitized assets |
| | | | | Net Interest Income Securitized Loans and Assets |
| | – | 251,292 | 251,292 | Interest from securitized loans and assets |
| | – | 180,681 | 180,681 | Interest on securitization liabilities |
| | – | 70,611 | 70,611 | Net interest income securitized loans and assets |
| | 193,862 | 70,168 | 264,030 | Total Net Interest Income |
| Provision for credit losses | 9,411 | 20 | 9,431 | Provision for credit losses |
| | 184,451 | 70,148 | 254,599 | |
| Non-Interest Income | | | | Non-Interest Income |
| Fees and other income | 30,690 | – | 30,690 | Fees and other income |
| Securitization income | 107,724 | (107,724) | – | |
| Gain on sale of loan portfolio | 3,917 | – | 3,917 | Gain on sale of loan portfolio |
| Realized net gains and unrealized losses on securities | 8,953 | 787 | 9,740 | Realized net gains and unrealized losses on securities |
| Net realized and unrealized loss on derivatives | 421 | 9,400 | 9,821 | Net realized and unrealized gain on derivatives |
| | 151,705 | (97,537) | 54,168 | |
| | 336,156 | (27,389) | 308,767 | |
| Non-Interest Expenses | | | | Non-Interest Expense |
| Salaries and benefits | 46,739 | – | 46,739 | Salaries and benefits |
| Premises | 6,894 | – | 6,894 | Premises |
| General and administrative | 40,306 | 1,537 | 41,843 | Other operating expenses |
| | 93,939 | 1,537 | 95,476 | |
| Income Before Income Taxes | 242,217 | (28,926) | 213,291 | Income Before Income Taxes |
| Income Taxes | | | | Income Taxes |
| Current | 35,231 | – | 35,231 | Current |
| Future | 26,042 | (2,734) | 23,308 | Deferred |
| | 61,273 | (2,734) | 58,539 | |
| NET INCOME | $ 180,944 | $ (26,192) | $ 154,752 | NET INCOME |
| NET INCOME PER COMMON SHARE | | | | NET INCOME PER COMMON SHARE |
| Basic | $ 5.21 | $ (0.75) | $ 4.46 | Basic |
| Diluted | $ 5.20 | $ (0.75) | $ 4.45 | Diluted |
| AVERAGE NUMBER OF COMMON SHARES OUTSTANDING | | | | AVERAGE NUMBER OF COMMON SHARES OUTSTANDING |
| Basic | 34,697 | – | 34,697 | Basic |
| Diluted | 34,776 | – | 34,776 | Diluted |
| Total number of outstanding common shares | 34,646 | – | 34,646 | Total number of outstanding common shares |
| Book value per common share | $ 21.42 | $ (3.28) | $ 18.14 | Book value per common share |

### Reconciliation of Consolidated Statement of Comprehensive Income

(thousands of Canadian dollars) For the Year Ended December 31, 2010

| Previous Canadian GAAP Line Items | Canadian GAAP Balance | IFRS Adjustments | IFRS Balance | IFRS Line Items |
|---|---|---|---|---|
| NET INCOME | $ 180,944 | $ (26,192) | $ 154,752 | NET INCOME |
| OTHER COMPREHENSIVE LOSS | | | | OTHER COMPREHENSIVE LOSS |
| Available for sale securities | | | | Available for sale securities |
| Net unrealized gains on securities available for sale | 3,224 | – | 3,224 | Net unrealized gains on securities available for sale |
| Net gains reclassified to net income | (8,270) | (239) | (8,509) | Net gains reclassified to net income |
| | (5,046) | (239) | (5,285) | |
| Income tax recovery | (2,507) | 1,521 | (986) | Income tax recovery |
| Total other comprehensive loss | (2,539) | (1,760) | (4,299) | Total other comprehensive loss |
| COMPREHENSIVE INCOME | $ 178,405 | $ (27,952) | $ 150,453 | COMPREHENSIVE INCOME |

### Adjustments to the Consolidated Statement of Cash Flows

The transition from previous Canadian GAAP to IFRS resulted in certain cash flows included in financing and investing activities under previous Canadian GAAP to be reclassified to operating activities under IFRS. Specifically, net changes in deposits were reclassified from financing activities to operating activities, and net changes in mortgages and personal and credit card loans were reclassified from investing activities to operating activities. In addition, certain cash flows related to the Company's securitization activities that were included in investing activities under previous Canadian GAAP are reflected in operating activities under IFRS.

# Corporate Directory

## HOME CAPITAL GROUP INC.

### Directors:

**James C. Baillie**[2,3]
Counsel
Torys LLP
Toronto, Ontario

**Hon. William G. Davis, P.C.,C.C.,Q.C.**[3,4]
Counsel
Davis Webb LLP
Brampton, Ontario

**Robert A. Mitchell, C.A.**[1,2,3]
Corporate Director
Oakville, Ontario

**William Falk**[1,2,3]
Executive Fellow
Mowat Centre for Policy Innovation
Grand Valley, Ontario

**Kevin P.D. Smith**[3,4]
Chairman of the Board and
Chief Exeutive Officer
St. Joseph's Health System
Hamilton, Ontario

**John M.E. Marsh**[1,4]
Corporate Director
Port Colborne, Ontario

**Gerald M. Soloway**
Chief Executive Officer
Home Capital Group Inc.
Toronto, Ontario

**Bonita Then**[1,2]
President and
Chief Executive Officer
Specialty Foods Group
Toronto, Ontario

**Leslie Thompson**[2,4]
President
LESRISK, Debt and Risk
Management Inc.
Toronto, Ontario

[1] Member of the Audit Committee
[2] Member of the Risk and Capital Committee
[3] Member of the Governance, Nominating and Conduct Review Committee
[4] Member of the Human Resources and Compensation Committee

### Committees:

**Audit Committee**
Robert A. Mitchell
*Chair*

Bonita Then
*Vice Chair*

**Risk and Capital Committee**
Bonita Then
*Chair*

**Governance, Nominating and Conduct Review Committee**
Hon. William G. Davis
*Chair*

**Human Resources and Compensation Committee**
Kevin P. D. Smith
*Chair*

John M.E. Marsh
*Vice Chair*

### Officers:

**Gerald M. Soloway**
*Chief Executive Officer*

**Martin Reid**
*President*

**Brian R. Mosko**
*Chief Operating Officer and Executive Vice President*

**Pino Decina**
*Senior Vice President, Residential Mortgage Lending*

**John R.K. Harry**
*Senior Vice President, Commercial Mortgage Lending*

**Robert Blowes, C.A., C.P.A**
*Chief Financial Officer*

**Chris Ahlvik, LL.B.**
*Senior Vice President, Corporate Counsel*

**Stephen Copperthwaite, CMA, ORMP**
*Vice President, Administration and Relationship Manager*

**Kerry Reinke, C.A.**
*Vice President, Enterprise Risk Management and Chief Risk Officer*

### Chair Emeritus:

**William A. Dimma**

### Annual and Special Meeting Notice

The Annual and Special Meeting of Shareholders of Home Capital Group Inc. will be held at the Design Exchange, Trading Floor, Second Floor, 234 Bay Street, Toronto, Ontario, on Wednesday, May 16, 2012 at 11:00 a.m. local time. Shareholders and guests are invited to join Directors and Management for lunch and refreshments following the Annual Meeting. All shareholders are encouraged to attend.

# Corporate Directory

## HOME TRUST COMPANY

### Directors

**Hon. William G. Davis, P.C.,C.C.,Q.C.**
*Chairman of the Board*

**James C. Baillie**

**William Falk**

**John M.E. Marsh**

**Robert A. Mitchell, C.A.**

**Martin Reid**

**Kevin P.D. Smith**

**Gerald M. Soloway**

**Bonita Then**

**Leslie Thompson**

### Officers

**Gerald M. Soloway**
*Chief Executive Officer*

**Martin Reid**
*President*

**Brian R. Mosko**
*Chief Operating Officer and Executive Vice President*

**Pino Decina**
*Senior Vice President, Residential Mortgage Lending*

**John R.K. Harry**
*Senior Vice President, Commercial Mortgage Lending*

**Robert Blowes, C.A., C.P.A**
*Chief Financial Officer*

**Chris Ahlvik, LL.B.**
*Senior Vice President, Corporate Counsel*

**Stephen Copperthwaite, CMA, ORMP**
*Vice President, Administration and Relationship Manager*

**Kerry Reinke, C.A.**
*Vice President, Enterprise Risk Management and Chief Risk Officer*

### Branches

**Toronto**
145 King Street West,
Suite 2300
Toronto, Ontario M5H IJ8
Tel: (416) 360-4663
1-800-990-7881
Fax: (416) 363-7611
1-888-470-2092

**Corporate**
Greg Parker
*Treasurer*

Donald Correia
*Vice President, Chief Credit Officer*

John Hong
*Vice President, Chief Compliance Officer and Chief Anti-Money Laundering Officer*

Dinah Henderson, CGA
*Vice President, Operations*

Marissa Lauder, C.A.
*Vice President, Finance*

Shawn Lyons, C.A.
*Vice President, Financial Operations and Corporate Accounting*

Sanjiv Purba
*Chief Information Officer*

Debbie Simon
*Vice President, Human Resources*

Marie Holland, C.A.
*Senior Vice President, Internal Audit*

Samar Smith
*Vice President, Internal Audit*

**Commercial Mortgage Lending**
Shaun Gonsalves
*Asst. Vice President*

**Residential Mortgage Lending**
Armando Diseri
*Vice President*

James Hill
Marguerite Ryan
*Directors*

Brendon Callender
Laurie Chalabardo
Alex Godfrey
Bobby Ramgoolam
*Asst. Vice Presidents*

Ron Cuadra
*Vice President, Sales and Marketing*

Vince Aggozino
*Director, National Sales*

Jeff Barbour
*Asst. Vice President, Credit*

Ivano Metallo
Scott Smith
Frank Tuzi
Jean-Pierre Vico
*Senior Managers*

Massimo DeNigris
Frank Femia
Monica Gairola
Michael Hewitt
Tim Nason
Michael Pagliocca
Vince Santacroce
Todd Wilson
*Managers*

**Sales and Service**
Domenic Cosentino
*Director*

**Direct Client Services**
Frank Lee
*Senior Manager*

**Visa Operations**
Raymond St. Aubin
*Asst. Vice President*

**PSiGate**
Angela Weidner
*Manager, Operations*

**Equityline *Visa***
Agostino Tuzi
*Vice President*

**Retail Credit Services**
Cathy Boon
*Vice President*

Wayne Dickie
*Asst. Vice President*

**Deposits**
Chandran Devan
*Senior Manager, Deposits*

Nicole Kotsifas
*Business Development Manager*

# Corporate Directory

**Calgary**
10655 Southport Road S.W.,
Suite 920
Calgary, Alberta T2W 4Y1
Tel: (403) 244-2432
1-866-235-3081
Fax: (403) 244-6542
1-866-544-3081
Jim Edwards
*Branch Manager*

Corbin Raison
*Senior Mortgage Underwriter*

**Vancouver**
200 Granville Street,
Suite 1288
Vancouver, B.C. V6C 1S4
Tel: (604) 484-4663
1-866-235-3080
Fax: (604) 484-4664
1-866-564-3524

Michael Forshee
*Director, Mortgage Lending*

Jim Bearman
*Senior Business Development Manager*

**Montreal**
2020 Rue University,
Suite 2420
Montreal, Quebec H3A 2A5
Tel: (514) 843-0129
1-866-542-0129
Fax: (514) 843-7620
1-866-620-7620
Danny Antoniazzi
*Branch Manager*

Carlo Vignone
*Team Leader*

**Halifax**
Duke Tower
5251 Duke Street,
Suite 1205
Halifax, Nova Scotia B3J 1P3
Tel: (902) 422-4387
1-888-306-2421
Fax: (902) 422-8891
1-888-306-2435
Scott Congdon
*Regional Manager, Mortgages*

David Neville
*Business Development Manager*

**Auditors**
Ernst & Young LLP
Chartered Accountants
Toronto, Ontario

**Principal Bankers**
Bank of Montreal
Bank of Nova Scotia

**Transfer Agent**
Computershare Investor Services Inc.
100 University Avenue
Toronto, Ontario M5J 2Y1
Tel: 1-800-564-6253

**Capital Stock**
As at December 31, 2011 there were 34,624,690 Common Shares outstanding.

**Stock Listing**
Toronto Stock Exchange
Ticker Symbol: HCG

**Memberships**
Canada Deposit Insurance Corporation
Trust Companies Association of Canada

**For Shareholder Information, Please Contact:**
Chris Ahlvik, LL.B.
*Senior Vice President, Corporate Counsel*
Home Capital Group Inc.
145 King Street West,
Suite 2300
Toronto, Ontario M5H 1J8
Tel: (416) 360-4663
Fax: (416) 363-7611
www.homecapital.com
www.hometrust.ca

**Home Capital Group Inc.**
Suite 2300
145 King Street West
Toronto, Ontario  M5H 1J8
Tel: 416-360-4663
Toll Free: 1-800-990-7881

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