

*Financial Statements of*

**ALTERNA BANK**

**December 31, 2018**

## *Independent auditor's report*

To the Shareholder of CS Alterna Bank

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### *Our opinion*

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of Alterna Bank as at December 31, 2018 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

### **What we have audited**

Alterna Bank's financial statements comprise:

- the balance sheet as at December 31, 2018;
  - the statement of income for the year then ended;
  - the statement of comprehensive income for the year then ended;
  - the statement of changes in shareholder's equity for the year then ended;
  - the statement of cash flows for the year then ended; and
  - the notes to the financial statements, which include a summary of significant accounting policies.
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### *Basis for opinion*

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the financial statements* section of our report.

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

### **Independence**

We are independent of Alterna Bank in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada. We have fulfilled our other ethical responsibilities in accordance with these requirements.

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### *Responsibilities of management and those charged with governance for the financial statements*

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

In preparing the financial statements, management is responsible for assessing Alterna Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate Alterna Bank or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing Alterna Bank's financial reporting process.

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## *Auditor's responsibilities for the audit of the financial statements*

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Alterna Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on Alterna Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause Alterna Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within Alterna Bank to express an opinion on the financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

*PricewaterhouseCoopers LLP*

**Chartered Professional Accountants, Licensed Public Accountants**

Ottawa, Ontario  
March 8, 2019

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**ALTERNA BANK****Balance Sheets** (in thousands of dollars)**December 31, 2018**

As at	Note	31 December 2018	31 December 2017
<b>ASSETS</b>			
Cash and cash equivalents	24	\$ 33,577	\$ 18,725
Investments	6	52,345	157,910
Loans and advances	4, 5	703,967	522,430
Property and equipment	7	19	35
Intangible assets	8	591	1,030
Derivative financial instruments	21	33	659
Deferred income tax asset	19	592	6
Other assets	9	19,299	18,356
		<b>\$ 810,423</b>	<b>\$ 719,151</b>
<b>LIABILITIES AND SHAREHOLDER'S EQUITY</b>			
Liabilities:			
Deposits	10	\$ 671,308	\$ 578,312
Mortgage securitization liabilities	12	75,597	83,609
Borrowings	11	-	4,499
Derivative financial instruments	21	1,902	310
Income tax payable		804	641
Other liabilities	13	4,188	2,899
		<b>753,799</b>	<b>670,270</b>
Shareholder's equity:			
Share capital	15	40,000	35,000
Retained earnings		16,727	13,160
Accumulated other comprehensive (loss) income		(103)	721
		<b>\$ 810,423</b>	<b>\$ 719,151</b>

*On behalf of the Board:*



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 Maria Barrados  
 Director




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 Richard J. Neville, FCPA, FCA  
 Director

(See accompanying notes to the financial statements)

**ALTERNA BANK**  
**Statements of Income** (in thousands of dollars)  
**December 31, 2018**

For the years ended	Note	31 December 2018	31 December 2017
Interest income	16	\$ 17,657	\$ 8,079
Investment income	17	2,597	4,853
		20,254	12,932
Interest expense	16	14,474	9,959
Net interest income		5,780	2,973
Loan costs		205	186
Net interest income after loan costs		5,575	2,787
Foreign exchange		3,675	1,177
Securitization income	18	2,019	2,906
Service charges		252	242
Commissions		210	200
Other		30	19
Other income		6,186	4,544
Net interest and other income		11,761	7,331
Administration		4,591	2,718
Salaries and benefits		1,551	1,507
Marketing and community relations		720	754
Occupancy		98	129
Operating expenses		6,960	5,108
Income before income taxes		4,801	2,223
Provision for income taxes	19	1,273	644
Net income		\$ 3,528	\$ 1,579

(See accompanying notes to the financial statements)

**ALTERNA BANK**  
**Statements of Comprehensive Income** (in thousands of dollars)  
**December 31, 2018**

For the years ended	31 December 2018	31 December 2017
Net income	\$ 3,528	\$ 1,579
Other comprehensive income (loss)		
Other comprehensive income (loss) to be reclassified to income in subsequent periods:		
<u>Available-for-sale securities:</u>		
Changes arising during the year <sup>(1)</sup>	N/A	588
Add: Reclassification adjustments for gains included in the income statement <sup>(2)</sup>	N/A	(180)
<u>Investments in debt instruments measured at fair value through other comprehensive income</u>		
Net unrealized losses on debt instruments measured at fair value through other comprehensive income <sup>(3)</sup>	(825)	N/A
<u>Cash flow hedges:</u>		
Changes arising during the year <sup>(4)</sup>	1	(68)
	(824)	340
Comprehensive income	\$ 2,704	\$ 1,919

<sup>(1)</sup> Net of income tax expense of \$214 in 2017.

<sup>(2)</sup> Net of income tax recovery of \$63 in 2017.

<sup>(3)</sup> Net of income tax recovery of \$297 in 2018.

<sup>(4)</sup> Net of income tax expense of \$4 in 2018 (2017 - \$26).

(See accompanying notes to the financial statements)

**ALTERNA BANK****Statements of Changes in Shareholder's Equity** (in thousands of dollars)**December 31, 2018**

For the years ended	Note	31 December 2018	31 December 2017
<b>Share capital:</b>			
Balance, beginning of year		\$ 35,000	\$ 15,000
Net shares issued		5,000	20,000
Balance, end of year		40,000	35,000
<b>Retained earnings, net of tax:</b>			
Balance, beginning of year		13,160	11,581
Impact of adoption IFRS 9 at January 1, 2018	3	39	N/A
Balance, beginning of year, as restated		13,199	11,581
Net income		3,528	1,579
Balance, end of year		16,727	13,160
<b>Accumulated other comprehensive (loss) income, net of tax:</b>			
Balance, beginning of year		721	381
Other comprehensive (loss) income		(824)	340
Balance, end of year		(103)	721
Shareholder's equity		\$ 56,624	\$ 48,881

(See accompanying notes to the financial statements)

**ALTERNA BANK**  
**Statements of Cash Flows** (in thousands of dollars)  
**December 31, 2018**

For the years ended	31 December 2018	31 December 2017
Operating activities:		
Net income	\$ 3,528	\$ 1,579
Proceeds from the securitization of mortgages	77,065	85,695
Payment of mortgage securitization liabilities	(85,274)	(23,321)
Add non-cash items:		
Provision for credit losses	145	145
Depreciation and amortization of		
Property and equipment	16	14
Intangible assets	626	207
Deferred charges	1,600	2,663
(Gain) loss on:		
Disposal of property and equipment	-	3
Sale of investments	-	(707)
Sale and securitization of loans	1,068	(2,980)
Decrease (increase) in assets:		
Fair value of investments	796	1,780
Fair value of loans	(2,316)	1,057
Interest receivable	529	(1,386)
Deferred income taxes	(292)	(84)
Loans, net of allowance for impaired loans	(180,723)	(324,870)
Receivable from parent company	1,629	37,653
Assets relating to derivative financial instruments	631	(654)
Increase in liabilities:		
Interest payable	558	266
Deposits	92,996	233,016
Liabilities relating to derivative financial instruments	1,592	196
Other items, net	(3,283)	1,208
Cash (used in) provided by operating activities	(89,109)	11,480
Investing activities:		
Proceeds from maturity and sale of investments	109,047	62,508
Purchase of investments	(5,400)	(147,835)
Acquisition of property and equipment	-	(9)
Acquisition of intangible assets	(187)	(744)
Cash provided by (used in) investing activities	103,460	(86,080)
Financing activities:		
Increase in borrowings	(4,499)	4,499
Issuance of common shares	5,000	20,000
Cash provided by financing activities	501	24,499
Net increase (decrease) in cash and cash equivalents during the year	14,852	(50,101)
Cash and cash equivalents, beginning of year	18,725	68,826
Cash and cash equivalents, end of year	\$ 33,577	\$ 18,725
Supplemental information:		
Interest paid	\$ 13,915	\$ 9,693
Interest received	\$ 18,186	\$ 6,693
Income taxes paid	\$ 1,372	\$ 136

(See accompanying notes to the financial statements)

# ALTERNA BANK

## Notes to the Financial Statements (in thousands of dollars)

December 31, 2018

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### 1. CORPORATE INFORMATION

CS Alterna Bank, a member of the Canada Deposit Insurance Corporation (“CDIC”), operates under the name “Alterna Bank”. It is a Schedule 1 Bank and received letters patent from the Minister of Finance of Canada to operate under the *Bank Act* on October 2, 2000. Alterna Bank is a wholly owned subsidiary of Alterna Savings. Alterna Savings is the ultimate parent.

The registered office address of Alterna Bank is 319 McRae Avenue, Ottawa, Ontario, K1Z 0B9. The nature of Alterna Bank’s operations and principal activities are the provision of deposit taking facilities and loan facilities to the clients of the bank across Canada.

The financial statements for the year ended December 31, 2018 were authorized for issue in accordance with a resolution of the Board of Directors on March 7, 2019. The Board of Directors has the power to amend the financial statements after issuance only in the case of a discovery of an error.

### 2. SIGNIFICANT ACCOUNTING POLICIES

#### STATEMENT OF COMPLIANCE

The financial statements of Alterna Bank have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”).

Alterna Bank presents its balance sheets broadly in order of liquidity.

Financial assets and liabilities are offset, with the net amount reported in the balance sheets, only if there is a currently enforceable legal right to set off the recognized amounts and there is an intention to settle on a net basis or to realize an asset and settle the liability simultaneously. In all other situations they are presented gross.

#### BASIS OF PREPARATION

The financial statements have been prepared on a historical cost basis, except for available-for-sale or fair value through other comprehensive income investments, derivative financial instruments and financial assets and financial liabilities held at fair value through profit or loss, which have been measured at fair value.

The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, revenues and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Actual results may differ from management’s estimates. The significant accounting policies are as follows:

#### a) CHANGES IN ACCOUNTING POLICIES

##### i) IFRS 9, *Financial Instruments* (“IFRS 9”)

Alterna Bank has adopted IFRS 9 with a date of transition of January 1, 2018, which resulted in changes in accounting policies and adjustments to the amounts previously recognized in the financial statements under IAS 39, *Financial Instruments: Recognition and Measurement* (“IAS 39”). Alterna Bank did not early adopt any of IFRS 9 in previous periods.

As permitted by the transitional provisions of IFRS 9, Alterna Bank elected not to restate comparative figures. Any adjustments to the carrying amounts of financial assets and financial liabilities at the date of transition were recognized in the opening retained earnings of the current period. Alterna Bank has also elected to continue to apply the hedge accounting requirements of IAS 39 on adoption of IFRS 9.

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**Notes to the Financial Statements**  
**December 31, 2018**

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Consequently, for note disclosure, the amendments to IFRS 7, *Financial Instruments: Disclosures* (“IFRS 7”) disclosures have also only been applied to the current period. The comparative period note disclosures repeat those disclosures made in the prior year.

The adoption of IFRS 9 has resulted in changes in Alterna Bank’s accounting policies for the recognition, classification and measurement of financial assets and impairment of financial assets. IFRS 9 also significantly amends other standards dealing with financial instruments such as IFRS 7.

Set out below in note 3 are disclosures relating to the impact of the adoption of IFRS 9. Further details of the specific IFRS 9 accounting policies applied in the current period (as well as the previous IAS 39 accounting policies applied in the comparative period) are described in more detail in sections (d) through (f) and (o) below.

**ii) IFRS 15, Revenue from Contracts with Customers (“IFRS 15”)**

Alterna Bank has adopted IFRS 15 with a date of transition of January 1, 2018. IFRS 15 supersedes previous revenue recognition guidance, which was found across several standards and interpretations. IFRS 15 establishes principles for reporting about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity’s contracts with customers. The standard provides a single, principles based five-step model for revenue recognition to be applied to contracts with customers except for revenue arising from items such as financial instruments, insurance contracts and leases. This adoption resulted in no changes to Alterna Bank’s financial statements or notes to the financial statements.

**b) CASH AND CASH EQUIVALENTS**

Cash and cash equivalents include cash on hand, cash on deposit with other financial institutions, cheques and other items in transit, and marketable securities with original maturities at acquisition of 90 days or less. Interest income on deposits with other financial institutions as well as marketable securities is included in investment income.

**c) DETERMINATION OF FAIR VALUE**

The fair value for financial instruments traded in active markets at the balance sheets date is based on their quoted market price without any deduction for transaction costs.

For all other financial instruments not traded in an active market, the fair value is determined by using appropriate valuation techniques. Valuation techniques include the discounted cash flow method, comparison to similar instruments for which market observable prices exist, options pricing models, credit models and other relevant valuation models.

Certain financial instruments are recorded at fair value using valuation techniques in which current market transactions or observable market data are not available. Their fair value is determined using a valuation model using the best estimate of the most appropriate model assumptions.

**d) FINANCIAL INSTRUMENTS**

**i) Initial recognition and measurement**

Financial instruments are recognized when Alterna Bank becomes party to the contractual provisions of the instrument. Regular purchases and sales of financial assets are recognized on the date when Alterna Bank commits to purchase or sell the asset.

At initial recognition, financial instruments are measured at fair value plus or minus transaction costs that are incremental and directly attributable to the acquisition or issue of the financial instrument, such as fees and commissions (for financial instruments not at fair value through profit or loss). For financial instruments carried at fair value through profit or loss, transaction costs are expensed in income.

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*Amortized cost and effective interest rate*

The amortized cost is the amount at which the financial instrument is measured at initial recognition minus principal repayment, plus or minus the cumulative amortization using the effective interest method of any difference between the initial amount and the maturity amount and, for financial assets, adjusted for any loss allowance.

The effective interest rate is the rate that discounts estimated future cash payments or receipts through the expected life of the financial instrument to the gross carrying amount (which is amortized cost before any loss allowance) of the financial asset or to the amortized cost of the financial liability. The calculation does not consider expected credit losses and includes transaction costs, premiums or discounts and fees paid or received that are integral to the effective interest rate such as origination fees.

When Alterna Bank revises the estimates of future cash flows, the carrying amount of the financial instrument is adjusted to reflect the new estimate discounted using the original effective interest rate. Changes are recognized in income.

Trade date accounting is used for all financial instruments.

**ii) Classification**

**Financial assets**

**Policy applicable from January 1, 2018**

From January 1, 2018, Alterna Bank has applied IFRS 9 and classifies its financial assets in the following measurement categories:

- Fair value through profit or loss (“FVTPL”);
- Fair value through other comprehensive income (“FVOCI”); or
- Amortized cost

A financial asset is measured at amortized cost if it meets both of the following conditions and is not designated at FVTPL:

- The asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest (“SPPI”) on the principal amount outstanding.

A debt instrument security is measured at FVOCI only if it meets both of the following conditions and is not designated at FVTPL:

- The asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- The contractual terms of the financial asset give rise on specified dates to cash flows that are SPPI on the principal amounts outstanding.

On initial recognition of an equity instrument security that is not held for trading, Alterna Bank may irrevocably elect to present subsequent changes in FVOCI. This election is made on an investment-by-investment basis. When this election is used, fair value gains and losses are recognized in other comprehensive income (loss) (“OCI”) and are not subsequently reclassified to profit or loss, including on disposal. Impairment losses (and reversal of impairment losses) are not reported separately from other changes in fair value. Dividends, when representing a return on such investments, continue to be recognized in profit or loss as other income when Alterna Bank’s right to receive payments is established. See note 3(a) for details on which investments Alterna Bank has taken the election on.

All other financial assets are classified as measured at FVTPL. In addition, on initial recognition, Alterna Bank may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortized cost or at FVOCI as at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

The classification requirements for debt and equity instrument securities are described below:

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Business model: the business model reflects how Alterna Bank manages the assets in order to generate cash flows. That is, whether the objective is solely to collect the contractual cash flows from the assets or is to collect both the contractual cash flows and cash flows from the sale of assets. If neither of these is applicable, then they are classified at FVTPL. Factors considered in determining the business model for a group of assets include past experience on how the cash flows for these assets were collected, how the asset's performance is evaluated and reported to key management, and how risks are assessed and managed.

SPPI: Where the business model is to hold assets to collect contractual cash flows or to collect contractual cash flows and sell, Alterna Bank assesses whether the financial asset's cash flows represent solely payment of principal and interest (the 'SPPI' test). In making this assessment, Alterna Bank considers whether the contractual cash flows are consistent with a basic lending arrangement i.e. interest includes only consideration for the time value of money, credit risk, other basic lending risks and a profit margin that is consistent with a basic lending arrangement. Where the contractual terms introduce exposure to risk or volatility that are inconsistent with a basic lending arrangement, the related financial asset is classified as FVTPL. Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are SPPI.

Financial assets are not reclassified subsequent to their initial recognition, except in the period after Alterna Bank changed its business model for managing financial assets.

**Policy applicable before January 1, 2018**

Alterna Bank classified its financial assets into one of the following categories:

**(i) Fair value through profit or loss**

Financial assets classified as FVTPL are financial assets and liabilities held for trading activities and are measured at fair value at the balance sheets date. Gains and losses realized on disposition and unrealized gains and losses from market fluctuations are both included in investment income.

**(ii) Available-for-sale**

Available-for-sale ("AFS") financial assets are those non-derivative financial assets that are designated as AFS, or that are not classified as loans and receivables, held-to-maturity ("HTM") or FVTPL. Financial assets classified as AFS are carried at fair value with the changes in fair value reported in accumulated other comprehensive income ("AOCI"), until sale or impairment occurs, at which time the cumulative gain or loss is transferred to the statements of income. For financial assets classified as AFS, changes in carrying amounts relating to changes in foreign exchange rate are recognized in the statements of income and other changes in carrying amount are recognized in AOCI as indicated above.

Equities that do not have quoted market values in an active market and where fair value cannot be reliably measured are carried at cost, less impairment. Realized gains and losses on sale as well as interest and dividend income from these securities are included in investment income.

**(iii) Loans and receivables**

Financial assets classified as loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market except those that are classified as AFS or designated as FVTPL. Refer to note 4 for details of loans designated as FVTPL. Loans and receivables are initially recognized at fair value plus directly related transaction costs. They are subsequently measured at amortized cost using the effective interest rate method less any impairment losses.

**Financial Liabilities**

In both the current and prior period, financial liabilities are classified and subsequently measured at amortized cost, except for derivative liabilities which are classified at FVTPL, where gains and losses realized on disposition and unrealized gains and losses from market fluctuations are both included in net gains on derivative financial instruments.

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**e) IMPAIRMENT OF FINANCIAL ASSETS**

**Policy applicable from January 1, 2018**

Alterna Bank recognizes loss allowances for expected credit losses (“ECL”) on the following financial instruments that are not measured at FVTPL:

- Loans at amortized cost;
- Financial assets that are debt instrument securities; and
- Loan commitments and guarantees.

No loss allowance is recognized on equity instrument securities.

Alterna Bank measures loss allowances at an amount equal to the lifetime ECL except for the following, for which they are measured as 12-month ECL:

- Debt investment securities that are determined to have low credit risk at the reporting date; or
- Loans at amortized cost on which credit risk has not increased significantly since their initial recognition.

All debt instrument securities were measured with 12-month ECL as they were determined to have a low credit risk as at the reporting date.

The credit risk on debt investment securities is considered low if there is:

- A low risk of default;
- The borrower has a strong capacity to meet contractual cash flow obligations; and
- Adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the ability of the counterparty to fulfil its contractual cash flow obligations.

Alterna Bank also considers debt instrument securities to have a low credit risk when its creditworthiness is judged to be ‘investment grade’, which Alterna broadly defines as equivalent to a credit rating of A or higher.

The 12-month ECL are the portion of ECL that result from default events on a financial instrument that are expected within the 12 months after the reporting date.

**i) Measurement of ECL**

ECL are a probability-weighted estimate of credit losses. They are measured as follows:

- Financial assets that are not credit-impaired at the reporting date: as the present value of all cash shortfalls (i.e., the difference between the cash flows due to the entity in accordance with the contract and the cash flows that Alterna Bank expects to receive);
- Financial assets that are credit-impaired at the reporting date: as the difference between the gross carrying amount and the present value of estimated future cash flows; and
- Undrawn loan commitments: as the present value of the difference between the contractual cash flows that are due to Alterna Bank if the commitment is drawn down and the cash flows that Alterna Bank expects to receive.

See further discussion in note 5.

**ii) Credit-impaired financial assets**

At each reporting date, Alterna Bank assesses whether financial assets carried at amortized cost and debt instrument securities carried at FVOCI are credit-impaired. A financial asset is ‘credit-impaired’ when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

Evidence that a financial asset is credit-impaired includes the following observable data:

- Significant financial difficulty of the borrower or issuer;
- A breach of contract such as a default or past due event;

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- The restructuring of a loan or advance by Alterna Bank on terms that Alterna Bank would not consider otherwise; or
- It is becoming probable that the borrower will enter bankruptcy or other financial reorganization.

A loan that has been renegotiated due to a deterioration in the borrower's condition is usually considered to be credit-impaired unless there is evidence that the risk of not receiving contractual cash flows has reduced significantly and there are no other indicators of impairment. In addition, a retail loan that is overdue for 90 days or more is considered impaired.

**Bad debt written off** - When it is considered that there is no realistic prospect of recovery, all efforts have ceased to collect amounts, and all collateral has been realized or transferred to Alterna Bank, the loan and any associated allowance is written off. Subsequent recoveries, if any, are credited to the allowance and recorded in the statements of income as a component of the loss allowance.

**Policy applicable before and after January 1, 2018**

**(i) Loans and loan impairment**

**Reversal of impairment losses** - If in a subsequent period the amount of a previously recognized impairment loss decreases, the impairment loss is reversed by reducing the allowance amount accordingly. Such reversal is recognized in the statements of income.

**Loan interest on impaired loans** - Once a loan is identified as impaired and the carrying amount is reduced by an impairment loss, interest income is recognized on the new carrying amount using the rate of interest used to discount the future cash flows for purposes of measuring the impairment loss.

**Transaction costs** - Transaction costs are revenues or expenses that are direct and incremental to the establishment of the loan. Transaction costs (e.g., commercial lending application fees, mortgage brokerage and incentive fees, legal fees, appraisal fees, etc.) are deferred and amortized to interest income over the term of the loan using the effective interest rate method. The net unamortized fees are included in the related loan balance.

**Loan costs** - Loan costs include the provision for loan losses, bad debt written off and collection costs.

**Restructured loans** - If the terms of a financial asset are renegotiated or modified or an existing financial asset is replaced with a new one due to financial difficulties of the borrower, then an assessment is made of whether the financial asset should be derecognized. Under IAS 39, the loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate. Under IFRS 9, the ECL are measured as follows:

- If the expected restructuring will not result in derecognition of the existing asset, then the expected cash flows arising from the modified financial asset are included in calculating the cash shortfalls from the existing asset; or
- If the expected restructuring will result in derecognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its derecognition. This amount is included in calculating the cash shortfalls from the existing financial asset that are discounted from the expected date of derecognition to the reporting date using the original effective interest rate of the existing financial asset.

**Policy applicable before January 1, 2018**

At each balance sheet date, Alterna Bank assesses whether there is objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or group of financial assets is impaired and loss allowance is incurred if there is:

- objective evidence of impairment as a result of a loss event that occurred after the initial recognition of the asset and up to the balance sheets date ("a loss event");
- the loss event had an impact on the estimated future cash flows of the financial asset or group of financial assets; and
- a reliable estimate of the amount can be made.

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A loss event may include indications that the borrower or a group of borrowers is experiencing significant difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganization and where observable data indicates that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

**(i) Loans and loan impairment**

Personal loans, residential mortgage loans and commercial loans are recorded at principal amounts less an allowance for impaired loans.

Alterna Bank establishes and maintains an allowance for impaired loans that is considered the best estimate of probable credit-related losses existing in its loan portfolio giving due regard to current conditions. The allowance includes both individual and collective provisions, reviewed on a regular basis by management. The allowance is increased by provisions for impaired loans, which are charged to income and reduced by write-offs, net of recoveries.

Alterna Bank first assesses whether objective evidence of impairment exists individually for loans that are individually significant. It then assesses collectively for loans that are not individually significant and loans that are significant but for which there is no objective evidence of impairment under the individual assessment.

**Bad debt written off** - When it is considered that there is no realistic prospect of recovery and all collateral has been realized or transferred to Alterna Bank, the loan and any associated allowance is written off. Subsequent recoveries, if any, are credited to the allowance and recorded in the statements of income as a component of loan costs.

**Individual allowance** - To allow management to determine whether a loss event has occurred on an individual basis, all significant counterparty relationships are reviewed periodically. The evaluation considers current information and events related to the counterparty, such as the counterparty experiencing significant financial difficulty or a breach of contract, for example, default or delinquency in interest or principal payments. If there is evidence of impairment leading to an impairment loss for an individual counterparty relationship, then the amount of the loss is determined as the difference between the carrying amount of the loan, including accrued interest, and the present value of expected future cash flows discounted at the loan's original effective interest rate, including cash flows that may result from foreclosure less costs for obtaining and selling the collateral. The carrying amount of the loan is reduced by the use of an allowance account and the amount of the loss is recognized in the statements of income as a component of loan costs.

**Collective allowance** - The collective assessment of impairment is principally to establish an allowance amount relating to loans that are either individually significant but for which there is no objective evidence of impairment, or are not individually significant, but for which there is, on a portfolio basis, a loss amount that is probable of having occurred and is reasonably estimable. The loans are grouped according to similar credit risk characteristics and the allowance for each group is determined using statistical models based on historical experience. Loans that were found not to be impaired when evaluated on an individual basis are included in the scope of this component of the allowance.

**(ii) Impairment of financial assets classified as available-for-sale**

For financial assets classified as AFS, Alterna Bank assesses at each balance sheets date whether there is objective evidence that the asset or group of assets is impaired.

In the case of equity instrument securities classified as AFS, objective evidence would include either a significant or a prolonged decline in the fair value of the investment below cost. 'Significant' is evaluated against the original cost of the investment and 'prolonged' against the period in which the fair value has been below its original cost. In the case of debt investment securities classified as AFS, impairment is assessed based on the same criteria used for loans.

Where there is evidence of impairment, the cumulative unrealized loss previously recognized in OCI is removed from OCI and recognized in the statements of income for the period. This amount is determined as the difference between the acquisition cost (net of any principal repayments and amortization) and current fair value of the asset less any impairment loss on that investment previously recognized in the statements of income. Impairment losses on equity instrument securities classified as AFS are not reversed through the statements of income; increases in their fair value after impairment are recognized in OCI.

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Reversals of impairment of debt investment securities are recognized in the statements of income if the recovery is objectively related to a specific event occurring after the impairment loss was recognized in the statements of income.

**f) MODIFICATIONS**

**i) Financial assets**

**Policy applicable from January 1, 2018**

If the terms of a financial asset are modified, Alterna Bank evaluates whether the cash flows of the modified asset are substantially different. If the cash flows are substantially different (at least 10%), then the contractual rights to the cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognized and a new financial asset is recognized at fair value.

If the cash flows of the modified asset carried at amortized cost are not substantially different, then the modification does not result in derecognition of the financial asset. In this case, Alterna Bank recalculates the gross carrying amount of the financial asset and recognizes the amount arising from adjusting the gross carrying amount as a modification gain or loss in income. If such a modification is carried out because of financial difficulties of the borrower, then the gain or loss is presented together with the loss allowance. In other cases, it is presented as interest income.

**ii) Financial liabilities**

**Policy applicable from January 1, 2018**

Alterna Bank derecognizes a financial liability when its terms are modified and the cash flows of the modified liability are substantially different. In this case, a new financial liability based on the modified terms is recognized at fair value. The difference between the carrying amount of the financial liability extinguished and the new financial liability with modified terms is recognized in income.

**g) DERECOGNITION OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES**

IFRS 9 does not change the derecognition assessment principles of IAS 39.

**i) Financial assets**

A financial asset (or, where applicable, a part of a financial asset or a part of a group of similar financial assets) is derecognized when:

- The rights to receive cash flows from the asset have expired; or
- Alterna Bank has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a “pass-through” arrangement; and either:
  - Alterna Bank has transferred substantially all the risks and rewards of the asset, or
  - Alterna Bank has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When Alterna Bank has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement but has neither transferred substantially all the risks and rewards of the asset nor control of the asset, the asset is recognized to the extent of Alterna Bank’s continuing involvement in the asset. In that case, Alterna Bank also recognizes an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that Alterna Bank has retained. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that Alterna Bank could be required to repay.

**ii) Financial liabilities**

A financial liability is derecognized when the obligation under the liability is discharged or cancelled or expires. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the

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original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in the statements of income.

**iii) Mortgage sales**

Alterna Bank may from time to time sell a portion of its securitized residential and commercial mortgage loan portfolio to diversify its funding sources and enhance its liquidity position. These transactions are accounted for in accordance with IAS 39 before January 1, 2018 and IFRS 9 as of January 1, 2018 and as such the related loans are derecognized from the balance sheets if the transaction meets the derecognition criteria through the transfer of certain risk and rewards to external parties. Gains or losses on these transactions are reported in other income on the statements of income. On certain transactions Alterna Bank retains substantially all the risks and rewards of the transferred loans. As a result, these loans remain on the balance sheets and the proceeds received are recognized as a liability in the balance sheets.

**h) DERIVATIVES AND HEDGING**

Alterna Bank has elected to continue to apply the hedge accounting requirements of IAS 39 on adoption of IFRS 9 as permitted by IFRS 9. The new hedge accounting disclosures required by the related amendments to IFRS 7, however are required for the annual period beginning January 1, 2018. Alterna Bank has not provided comparative information for 2017 of IFRS 9 for the new disclosures as permitted by IFRS 7.

All derivatives are carried at fair value and are reported as assets where they have a positive fair value and as liabilities where they have a negative fair value as “derivative financial instruments” on the balance sheets.

Gains and losses arising from changes in the fair value of a derivative are recognized as they arise in the statements of income unless the derivative is the hedging instrument in a qualifying hedge (see “hedge accounting” below).

**i) Embedded derivatives**

Embedded derivatives are separated from non-financial assets. Derivatives embedded in other financial instruments are valued as separate derivatives when their economic characteristics and risks are not considered to be closely related to the host contract. These embedded derivatives are classified as derivative financial instruments and measured at fair value with changes therein recognized in the statements of income. The only embedded derivatives are the options embedded in Alterna Bank’s indexed term deposits offered to clients (note 21(b)), with respect to which the host deposits are carried at amortized cost.

**ii) Hedge accounting**

Alterna Bank uses derivative financial instruments such as swaps in its management of interest rate exposure. Derivative financial instruments are not used for trading or speculative purposes but rather as economic hedges, some of which qualify for hedge accounting. Alterna Bank applies hedge accounting for derivative financial instruments that meet the criteria specified in IAS 39. When hedge accounting is not applied, the change in the fair value of the derivative financial instrument is recognized in income. This includes instruments used for economic hedging purposes that do not meet the requirements for hedge accounting.

Where hedge accounting can be applied, a hedge relationship is designated and formally documented at its inception, outlining the particular risk management objective and strategy, the specific asset, liability or cash flow being hedged, as well as how hedge effectiveness will be assessed. The assessment of the effectiveness of the derivatives that are used in hedging transactions in offsetting changes in cash flows of the hedged items both at the hedge inception and on an ongoing basis must be documented. Ineffectiveness results to the extent that the cumulative change in the fair value of the hedging derivative differs from the cumulative change in the fair value of expected future cash flows of the hedged item. Effectiveness requires a high correlation of changes in cash flows. The amount of ineffectiveness, provided that it is not to the extent to disqualify the entire hedge from hedge accounting, is recognized immediately in income.

**iii) Cash flow hedges**

Alterna Bank designates cash flow hedges as part of risk management strategies that use derivatives to mitigate our exposure to the changes in cash flows of variable rate instruments. The effective portion of the change in fair value of the derivative instrument is offset through OCI as discussed below until the cash flows being hedged are recognized in income in future accounting periods, at which time the amount that was recognized in OCI is reclassified into income. The

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ineffective portion of the change in fair value of the hedging derivative is recognized separately in unrealized gains/(losses) on financial instruments immediately as it arises. If the hedging instrument expires or is sold, terminated or exercised, or where the hedge no longer meets the criteria for hedge accounting, the hedge relationship is terminated and any remaining amount in OCI is recognized in income over the remaining term of the hedged item. In the event that the hedged transaction is no longer likely of occurring, the OCI balance is then recognized in the statements of income.

**i) FOREIGN CURRENCY**

The financial statements are presented in Canadian dollars, which is Alterna Bank's functional and reporting currency.

Monetary assets and liabilities denominated in a foreign currency are translated into Canadian dollars at the rate of exchange prevailing at the balance sheets date; income and expenses are translated at the annual average rate. Foreign currency exchange gains and losses are recognized in other income during the year.

**j) PROPERTY AND EQUIPMENT**

Property and equipment are carried at cost less accumulated depreciation and accumulated impairment losses. Depreciation is generally recognized using the straight-line basis over the estimated useful lives of the assets. The range of estimated useful lives of the assets is as follows:

Furniture and equipment	5 to 10 years
Leasehold improvements	Term of the lease

Depreciation of property and equipment is included in administration and occupancy expenses. Maintenance and repairs are also charged to administration and occupancy expenses. Gains and losses on disposals are included in other income.

Property and equipment are tested for impairment at least annually and an impairment charge is recorded to the extent the recoverable amount, which is the higher of fair value less costs to sell and value in use, is less than its carrying amount. Value in use is the present value of the future cash flows expected to be derived from the asset. After the recognition of impairment of an asset, the depreciation charge is adjusted in future periods to reflect the asset's revised carrying amount. If impairment is later reversed, the depreciation charge is adjusted prospectively.

Property and equipment is derecognized on disposal or when no future economic benefits are expected from its use. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is recognized in other income in the statements of income in the year the asset is derecognized.

**k) INTANGIBLE ASSETS**

Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and accumulated impairment losses.

The useful lives of intangible assets are assessed as either finite or indefinite.

Intangible assets with a finite life are amortized on a straight-line basis over the estimated useful lives of the assets. Alterna Bank's computer software has been identified as having a finite life and is amortized over 2 to 3 years.

**l) INCOME TAXES**

**i) Current tax**

Current tax assets and liabilities for the current and prior years are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are substantively enacted by the balance sheets date.

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**ii) Deferred income tax**

Deferred income tax is provided on temporary differences at the balance sheets date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax assets are recognized for all deductible temporary differences, carry forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry forward of unused tax credits and unused tax losses can be utilized.

The carrying amount of deferred income tax assets is reviewed at each balance sheets date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilized. Unrecognized deferred income tax assets are reassessed at each balance sheets date and are recognized to the extent that it has become probable that future taxable profit will allow the deferred income tax asset to be recovered.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet dates.

Current tax and deferred income tax relating to items recognized directly in equity are also recognized in equity and not in the statements of income.

Deferred income tax assets and deferred income tax liabilities are offset if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred income taxes relate to the same taxable entity and the same taxation authority.

**m) LEASING**

The determination of whether an arrangement is a lease, or it contains a lease, is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

Leases that do not transfer to Alterna Bank substantially all the risks and benefits incidental to ownership of the leased items are operating leases. Operating lease payments are recognized as an expense in the statements of income on a straight-line basis over the lease term. Contingent rental payables are recognized as an expense in the period in which they are incurred.

Operating lease costs are recognized as an expense on a straight-line basis over the lease term, which commences when the lessee controls the physical use of the property.

**n) RECOGNITION OF INCOME AND EXPENSES**

Revenue is recognized when the amount of revenue and associated costs can be reliably measured and it is probable that economic benefits associated with the transaction will be realized. The following specific recognition criteria are used for the recognition of income and expenses.

**i) Interest income and interest expense**

Interest income and expense are recognized in the statements of income for all interest-bearing financial instruments, except for those designated as FVTPL, using the effective interest rate method. The estimated future cash flows used in this calculation include those determined by the contractual terms of the asset or liability, all fees considered integral to the effective interest rate, direct and incremental transaction costs, and all other premiums or discounts.

Interest income is calculated by applying the effective interest rate to the gross carrying amount of financial assets except for those that have become credit-impaired, for which interest revenue is calculated by applying the effective interest rate to their amortized cost.

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**ii) Other income**

Service charges, commissions and other revenues are recognized as revenue when the related services are performed or are provided.

**o) SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATES**

In the process of applying accounting policies, management has exercised judgment and estimates in determining the amounts recognized in the financial statements. The most significant uses of judgment and estimates are as follows:

**i) Fair value of financial instruments**

Alterna Bank measures financial instruments such as cash and cash equivalents, investments classified as AFS before January 1, 2018, FVOCI after January 1, 2018, or designated as FVTPL and derivatives at fair value at each balance sheets date.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction takes place in the principal market for the asset or liability or, in the absence of a principal market, in the most advantageous market for the asset or liability.

The fair value of the asset or liability is measured using the assumptions that market participants would use when pricing the asset or liability and assuming they act in their economic best interest.

A fair value measurement of a non-financial asset (e.g., property and equipment) takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

Alterna Bank uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorized within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

Level 1 — Quoted market prices in active markets for identical assets or liabilities.

Level 2 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable.

Level 3 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

For assets and liabilities that are recognized in the financial statements on a recurring basis, Alterna Bank determines whether transfers have occurred between levels in the hierarchy by re-assessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period. There are no assets or liabilities measured at fair value that have been categorized within Level 3 of the fair value hierarchy.

For the purposes of fair value disclosure, Alterna Bank has determined the classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy as explained above.

**ii) Impairment losses on loans and advances before January 1, 2018**

Alterna Bank reviews its individually significant loans and advances at each balance sheets date to assess whether an impairment loss should be recorded in the statements of income. In particular, judgment by management is required in the estimation of the amount and timing of future cash flows when determining the impairment loss. In estimating these cash flows, Alterna Bank makes judgments about the borrower's financial situation and the net realizable value of collateral. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowance.

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Loans and advances that have been assessed individually and found not to be impaired and all individually insignificant loans and advances are then assessed collectively, in groups of assets with similar risk characteristics, to determine whether a provision should be made due to incurred loss events for which there is objective evidence but of which effects are not yet evident. The collective assessment takes account of data from the loan portfolio (such as credit quality, levels of arrears, credit utilization, loan to collateral ratios, etc.), concentrations of risks and economic data (including levels of unemployment, real estate prices indices and the performance of different individual groups).

The impairment loss on loans and advances is disclosed in more detail in note 5.

**iii) Impairment of available-for-sale investments before January 1, 2018**

Alterna Bank reviews its securities designated as AFS investments at each balance sheets date to assess whether they are impaired. This requires similar judgment as applied to the individual assessment of loans and advances.

**iv) Measurement of the ECL applicable as of January 1, 2018**

Under IFRS 9, the measurement of the ECL allowance for financial assets measured at amortized cost and debt instrument securities measured at FVOCI requires the use of complex models and significant assumptions about future economic condition and credit behaviour (e.g. the likelihood of customers defaulting and the resulting losses).

A number of significant judgements are also required in applying the accounting requirements for measuring ECL, such as:

- Determining criteria for significant increase in credit risk;
- Choosing appropriate models and assumptions for the measurement of ECL; and
- Establishing the number and relative weightings of forward-looking scenarios for each type of product/market and the associated ECL.

Explanations of the inputs, assumptions and estimation techniques used in measuring ECL is further detailed in note 5 which also sets out key sensitivities of the ECL to changes in these elements.

**v) Deferred income tax assets**

Deferred income tax assets are recognized in respect of tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilized. Judgment is required to determine the amount of deferred income tax assets that can be recognized, based upon the likely timing and level of future taxable profits.

**p) NEW STANDARDS AND INTERPRETATIONS NOT YET ADOPTED**

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended December 31, 2018 and have not been applied in preparing the financial statements. Alterna Bank does not intend to adopt any of these standards early. The standard below is expected to have an impact on the financial statements of Alterna Bank:

**IFRS 16, Leases (“IFRS 16”) (replacement of IAS 17)**

IFRS 16 was issued in 2016 and sets out the principles for recognition, measurement, presentation and disclosure of leases for both parties to a contract. The new standard replaces the previous lease standard, IAS 17, *Leases*. Changes are primarily to lessee accounting. The new standard calls for all leases with a duration of more than 12 months to be reflected on-balance sheet. A financial liability will be recognized for the lease obligation. A corresponding non-financial asset will be recognized for the right-of-use asset. The obligation covers the full lease term which includes the non-concealable lease period plus any optional renewal periods where there is significant economic incentive for the lessee to exercise.

For lessees, all lease liabilities will be recorded at fair value and lease payments will be split between interest expense and principal reductions. The right-of-use asset will be amortized straight-line over the shorter of the useful life of the asset or the term of the lease. In effect, this will result in higher expense in the early years of the lease as interest expense will decrease over time.

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Alterna Bank has one operating lease, which is accounted for off-balance sheet. The lease payments are reflected in profit or loss as incurred. The new standard is effective for annual periods beginning on or after January 1, 2019. The impact of the revised standard on Alterna Bank's financial position and performance is currently being assessed.

**3. ADOPTION OF IFRS 9**

**a) Classification and measurement of financial instruments**

The measurement category and the carrying amount of financial assets in accordance with IAS 39 at December 31, 2017 and IFRS 9 at January 1, 2018 are compared as follows. All reclassifications are from retired categories with no change in measurement as noted below:

- Those previously classified as AFS are now classified as measured at FVOCI; and
- Those previously classified as HTM or loans and receivables are now classified at amortized cost.

There have been no changes to the classification of financial liabilities.

(000s)	IFRS 9		IAS 39	
	Measurement Category	Carrying amount 1 Jan 2018	Measurement Category	Carrying amount 31 Dec 2017
<b>Financial assets</b>				
Cash and cash equivalents	<b>Amortized cost</b>	\$ 18,725	Cash and cash equivalents	\$ 18,725
Investments				
- Term deposits	<b>FVOCI (Debt)</b>	<b>101,038</b>	Available-for-sale	101,038
- Money market instruments	<b>FVOCI (Debt)</b>	<b>12,220</b>	Available-for-sale	12,220
- Securities issued or guaranteed by Sovereigns	<b>FVTPL (Designated)</b>	<b>44,592</b>	FVTPL	44,592
- Other investments	<b>FVOCI (Equity)</b>	<b>60</b>	Available-for-sale	60
Derivative financial instruments	<b>FVTPL (Mandatory)</b>	<b>659</b>	FVTPL	659
Loans				
- Personal loans	<b>Amortized cost</b>	<b>17,794</b>	Loans and receivables	17,794
- Residential mortgage loans at amortized cost	<b>Amortized cost</b>	<b>352,239</b>	Loans and receivables	352,239
- Residential mortgage loans at fair value	<b>FVTPL (Mandatory)</b>	<b>132,441</b>	FVTPL	132,441
- Commercial loans at amortized cost	<b>Amortized cost</b>	<b>12,821</b>	Loans and receivables	12,821
- Commercial loans at fair value	<b>FVTPL (Mandatory)</b>	<b>7,283</b>	FVTPL	7,283
		<b>\$ 699,872</b>		<b>\$ 699,872</b>

\*Sovereigns - Direct Obligations of the Government of Canada or any obligations directly guaranteed by the Government of Canada.

**b) Reconciliation of financial instruments from IAS 39 to IFRS 9**

The following table reconciles the prior period's closing loss allowance measured in accordance with the IAS 39 incurred loss model to the new loss allowance measured in accordance with the IFRS 9 expected loss model at January 1, 2018.

(000s)	Personal Loans	Residential Mortgage	Total
<b>Loans and advances</b>			
Closing loss allowance, IAS 39, 31 Dec 2017	\$ 68	\$ 80	\$ 148
Remeasurement under IFRS 9	(26)	(13)	(39)
Opening loss allowance, IFRS 9, 1 Jan 2018	\$ 42	\$ 67	\$ 109

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**4. LOANS AND ADVANCES**

(000s)	31 Dec 2018	31 Dec 2017
Loans and advances at amortized cost:		
Personal loans	\$15,853	\$17,794
Residential mortgage loans	423,696	352,239
Commercial loans	7,597	12,821
	<b>447,146</b>	<b>382,854</b>
Less: Loss allowance (note 5)	(117)	(148)
<b>Total loans and advances at amortized cost</b>	<b>\$447,029</b>	<b>\$382,706</b>
Loans and advances at FVTPL:		
Residential mortgage loans	252,640	132,441
Commercial loans	4,298	7,283
<b>Total loans and advances at FVTPL</b>	<b>\$256,938</b>	<b>\$139,724</b>
	<b>\$703,967</b>	<b>\$522,430</b>

**5. NATURE AND EXTENT OF RISKS ARISING FROM FINANCIAL INSTRUMENTS**

Alterna Bank is exposed to the following risks as a result of holding financial instruments: credit risk, market risk and liquidity risk. The following is a description of those risks and how Alterna Bank manages the exposure to them.

**a) CREDIT RISK**

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. For Alterna Bank, the three main asset classes exposed to credit risk are loans, investments and derivative financial instruments on the balance sheets.

Alterna Bank's credit risk objective is to minimize this financial loss. Credit risk is managed in accordance with the Credit Policy for loans and the Investment/Derivative Policy for investments and derivatives. These policies are reviewed and approved annually by the Board of Directors (the "Board").

For loans, Alterna Bank mitigates its credit risk exposure by:

- defining its target market area;
- limiting the principal amount of credit to a borrower at any given time: \$100,000 in unsecured personal loans per borrower, \$1,500,000 in residential mortgage loans per borrower, \$4,000,000 in commercial mortgage loans and collateral demand or term loans per borrower and \$4,000,000 in aggregate loans per borrower and connected persons;
- performing a credit analysis prior to the approval of a loan;
- obtaining collateral when appropriate;
- employing risk-based pricing; and
- limiting the concentration by industry and geographic location for commercial loans.

Loan exposures are managed and monitored through facility limits for individual and connected borrowers and a credit review process. This review ensures that the borrower complies with internal policy and underwriting standards. Alterna Bank relies on collateral security typically in the form of a fixed and floating charge over the assets of its borrowers. Credit risk is also managed through regular analysis of the ability of clients to meet interest and principal repayment obligations and by changing these lending limits where appropriate.

Alterna Bank holds collateral against loans and advances to clients in the form of mortgage interests over property, other registered securities over assets, and guarantees. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and generally are not updated except when a loan is either renewed or individually assessed as impaired.

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Alterna Bank liquidates the collateral asset to recover all or part of the outstanding exposure in cases where the borrower is unable or unwilling to fulfil its primary obligations.

Credit risk is limited for mortgages secured by residential properties as 58% (2017 – 54%) of these mortgages are insured by mortgage insurance companies. Alterna Bank also monitors the concentration risk from commercial loans by setting maximum exposure limits for total loan balances for each industry. The carrying amount of financial assets recorded in the financial statements net of impairment losses, represents Alterna Bank’s maximum exposure to credit risk without taking account of the value of any collateral obtained.

Alterna Bank mitigates counterparty credit risk of investments and derivatives by aggregating counterparty exposure for each issuer and adhering to the quality guidelines as noted in its Investment/Derivative policy. Investments other than those issued by the Government of Canada and its Crown Corporations as well as liquidity reserve investments and shares held as a condition of membership with Central 1 are diversified by limiting investments in any one issuer to a maximum of 25% of total regulatory capital.

For investments and derivatives, risk is measured by reviewing exposure to individual counterparties to ensure total fair value of investments and derivatives is within the policy limit. This also mitigates concentration risk in the portfolio. The quality of the counterparties is assessed through two published credit rating agencies, DBRS and S&P.

Alterna Bank does not have any significant credit risk exposure to any single counterparty or any group of counterparties having similar characteristics by establishing prudent limits.

**Policy applicable from January 1, 2018**

**(i) Amounts arising from ECL**

**Measurement of ECL**

IFRS 9 outlines a ‘three-stage’ model for impairment based on changes in credit quality since initial recognition as summarized below:

- A financial instrument that is not credit-impaired on initial recognition is classified in ‘stage 1’ and has credit risk continuously monitored.
- If there is a significant increase in credit risk (“SICR”) since initial recognition, the financial instrument is moved to ‘stage 2’ but is not yet deemed to be credit-impaired.
- If the financial instrument is credit-impaired, it is moved to ‘stage 3’.
- Financial instruments in Stage 1 have their ECL measured at an amount equal to the portion of lifetime ECL that result from default events possible within the next 12 months. Instruments in stages 2 or 3 have their ECL measured based on ECLs on a lifetime basis.
- Purchased or originated credit-impaired financial assets are those that are credit-impaired on initial recognition. Their ECL are always measured at stage 3.

The key inputs into the measurement of ECL are the term structure of the following variables:

- Probability of default (“PD”);
- Loss given default (“LGD”); and
- Exposure at default (“EAD”).

These parameters are generally derived from externally developed statistical models and purchased market data. They are adjusted to reflect forward-looking information as described above.

PD estimates are estimates at a certain date, which are determined based on credit risk rating frameworks, and assessed using rating tools tailored to the various categories of counterparties and exposures. These credit risk ratings are based on externally purchased market data comprising both quantitative and qualitative factors. If a counterparty or exposure migrates between rating classes, then this will lead to a change in the estimate of the associated PD. PDs are estimated considering the contractual maturities of exposures and estimated prepayment rates.

LGD is the magnitude of the likely loss if there is a default. Alterna Bank estimates LGD parameters based on the history of recovery rates of claims against defaulted counterparties. The LGD models consider the structure, collateral, seniority

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of the claim, counterparty industry and recovery costs of any collateral that is integral to the financial asset. For loans secured by property, loan-to-value ratios are a key parameter in determining LGD. LGD estimates are recalibrated for different economic scenarios and, for real estate lending, to reflect possible changes to property prices. They are calculated using the weighted average of five-year actual loss experiences.

EAD represents the expected exposure in the event of a default. Alterna Bank derives the EAD from the current exposure to the counterparty and potential changes to the current amount allowed under the contract including amortization. The EAD of a financial asset is its gross carrying amount. For lending commitments and financial guarantees, the EAD includes the amount drawn, as well as potential future amounts that may be drawn under the contract, which are estimated based on historical observations and forward-looking forecasts.

As described above, and subject to using any maximum of a 12-month PD for financial assets for which credit risk has not significantly increased, Alterna Bank measures ECL considering the risk of default over the maximum contractual period (including any borrower's extension options) over which it is exposed to credit risk, even if, for risk management purposes, Alterna Bank considers a longer period. The maximum contractual period extends to the date at which Alterna Bank has the right to require repayment of an advance or terminate a loan commitment or guarantee.

However, for line of credit facilities that include both a loan and an undrawn component, Alterna Bank measures ECL over a period longer than the maximum contractual period. This occurs if Alterna Bank's contractual ability to demand repayment and cancel the undrawn commitment does not limit Alterna Bank's exposure to credit losses to the contractual notice period. These facilities do not have a fixed term or repayment structure and are managed on a collective basis. Alterna Bank can cancel them with immediate effect but this contractual right is not enforced in the normal day-to-day management, but only when Alterna Bank becomes aware of an increase in credit risk at the facility level. This longer period is estimated taking into account the credit risk management actions that Alterna Bank expects to take and that serve to mitigate ECL. These include a reduction in limits, cancellation of the facility and/or turning the outstanding balance into a loan with fixed repayment terms. For lines of credit, Alterna Bank will consider an estimation of future draw downs. For retail loans, this has been determined as 85% of the undrawn retail and 5% of the undrawn commercial line of credit in ECL calculation that will be a fair representation of Alterna Bank's actual loss and LOC limit utilization experience.

For measuring ECL, the estimate of expected cash shortfalls includes the cash flows expected from collateral or proceeds from credit insurance that are part of the contractual terms.

**SICR**

When determining whether the risk of default on a financial instrument has increased significantly since recognition, Alterna Bank considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis, based on Alterna Bank's historical experience, expert credit assessment and forward-looking information.

The objective of the assessment is to identify whether a significant increase in credit risk has occurred for an exposure by comparing:

- The remaining lifetime PD as at the reporting date; with
- The remaining lifetime PD for this point in time that was estimated at the time of initial recognition of the exposure (adjusted where relevant for changes in prepayment expectations).

The criteria for determining whether credit risk has increased significantly vary by portfolio and include quantitative changes in PDs and qualitative factors.

Alterna Bank considers that a significant increase in credit risk occurs no later than when a loan is more than 30 days past due. Days past due are determined by counting the number of days since the earliest-elapsing due date in respect of which full payment has not been received. Due dates are determined without considering any grace period that might be available to the borrower.

Alterna Bank monitors the effectiveness of the criteria used to identify significant increases in credit risk by regular reviews to confirm that:

- The criteria are capable of identifying significant increases in credit risk before an exposure is in default; and

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- There is no unwarranted volatility in loss allowance from transfers between 12-month PD (stage 1) and lifetime PD (stage 2).

**Risk ratings**

Alterna Bank allocates each commercial exposure to a credit risk rating (“risk rating”) based on a variety of data that is determined to be predictive of the risk of default and by applying experienced credit judgment. Risk ratings are defined using qualitative and quantitative factors that are indicative of risk of default. These factors vary depending on the nature of the exposure and the type of borrower.

Risk ratings are defined and calibrated such that the risk of default occurring increases exponentially as the credit risk deteriorates so, for example, the difference in risk of default between risk rating 1 and 2 is smaller than the difference between the risk rating level 2 and 3.

Each exposure is allocated to a risk rating at initial recognition based on available information about the borrower. Exposures are subject to ongoing monitoring, which may result in an exposure being moved to a different risk rating. The monitoring typically involves use of the following data:

- Information obtained during periodic review of borrower files (e.g. financial statements, budgets and projections). Examples of areas of particular focus are gross profit margins, financial leverage ratios, debt service coverage, compliance with covenants, quality of management, and senior management changes;
- Data from credit reference agencies, press articles, changes in external credit ratings; and
- Actual and expected significant changes in the political, regulatory and technological environment of the borrower or in its business activities.

**Beacon Scores**

For retail, the staging is done at a loan level. Alterna Bank uses quarterly updates of Equifax Risk Score credit scores and a table that translates these scores into PDs.

**Other factors contributing to a SICR**

- Qualitative elements: Alterna Bank monitors qualitative indicators to suggest a significant increase in credit risk such as bankruptcy and consumer proposal.
- Backstop indicators: Financial assets that are more than 30 days past due are assumed to have a SICR and are stage 2 assets. Similarly, financial assets that are more than 90 days past due are assumed to be financial assets with credit risk that has increased to the point that they are considered credit-impaired and stage 3 assets.

**Generating the term structure of PD**

Risk ratings and beacon scores are primary inputs into the determination of PDs for exposures. Alterna Bank collects performance and default information about its credit risk exposures analyzed by type of product, borrower and risk ratings or beacon scores. For some portfolios, information purchased from external credit reference agencies is also used.

**Forward-looking information**

Alterna Bank employs statistical models to analyze the data collected and generate estimates of the remaining lifetime PD of exposures and how these are expected to change as a result of the passage of time.

This analysis includes the identification and calibration of relationships between changes in default rates, changes in key macro-economic factors and in-depth analysis of the impact of certain other factors on the risk of default. For most exposures, key macro-economic indicators include Canadian equity, unemployment and oil price or Canada BBB spread for the commercial portfolio and Province level Housing Price Index and unemployment for the retail portfolio.

Based on assessments from the Credit Risk Management Committee and consideration of a variety of external actual and forecast information, Alterna Bank formulates a ‘base case’ view of the future direction of relevant economic variables as well as a representative range of other possible forecast scenarios, both negative and positive. Alterna Bank then uses these forecasts to adjust its estimates of PD.

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#### Modified financial assets

The contractual terms of a loan may be modified for a number of reasons, including changing market conditions, customer retention and other factors not related to a current or potential credit deterioration of the customer. An existing loan whose terms have been modified may be derecognized and the renegotiated loan recognized as a new loan at fair value in accordance with the accounting policy set in note 2.

When the terms of a financial asset are modified and the modification does not result in derecognition, the determination of whether the asset's credit risk has increased significantly reflects comparison of:

- Its remaining lifetime PD at the reporting date based on the modified terms; with
- The remaining lifetime PD estimated based on data at initial recognition and the original contractual terms.

Alterna Bank renegotiates loans to customers in financial difficulties (referred to as 'forbearance activities') to maximize collection opportunities and minimize the risk of default. Loan forbearance is granted on a selective basis if the debtor is currently in default on its debt or if there is a high risk of default, there is evidence that the debtor made all reasonable efforts to pay under the original contractual terms and the debtor is expected to be able to meet the revised terms.

The revised terms typically include extending the maturity, changing the timing of interest payments and amending the terms of loan covenants. This applies to both retail and commercial loans.

For financial assets modified as part of Alterna Bank's forbearance policy, the estimate of PD reflects whether the modification has improved or restored Alterna Bank's ability to collect interest and principal and Alterna Bank's previous experience of similar forbearance action. As part of this process, Alterna Bank evaluates the borrower's payment performance against the modified contractual terms and considers various behavioural indicators.

Generally, forbearance is a qualitative indicator of a significant increase in credit risk and an expectation of forbearance may constitute evidence that an exposure is credit-impaired/in default. A customer needs to demonstrate consistently good payment behaviour over a period of time before the exposure is no longer considered to be credit-impaired/in default or the PD is considered to have decreased such that the loss allowance reverts to being measured at an amount equal to 12-month ECL.

There were no material modifications during the reporting period.

#### Definition of default

Alterna Bank defines a financial instrument as in default, which is fully aligned with the definition of credit-impaired, when it meets one or more of the following criteria:

- The borrower is unlikely to pay its credit obligations to Alterna Bank in full, without recourse by Alterna Bank to actions such as realizing security (if any is held); or
- The borrower is past due more than 90 days on any material credit obligation to Alterna Bank. Overdrafts are considered as being past due once the customer has breached an advised limit or been advised of a limit smaller than the current amount outstanding.

In assessing whether a borrower is in default, Alterna Bank also considers indicators that are:

- Qualitative – e.g., breaches of covenant;
- Quantitative – e.g., overdue status and non-payment on another obligation of the same issuer to Alterna Bank; and
- Based on data developed internally and/or obtained from external sources.

Inputs into the assessment of whether a financial instrument is in default and their significance may vary over time to reflect changes in circumstances.

The definition of default largely aligns with that applied by Alterna Bank for regulatory capital purposes.

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**Reconciliation of opening to closing balance of the loss allowance**

The following tables show reconciliations from the opening to the closing balance of the loss allowance by class of financial instrument. Refer to note 3 for a reconciliation between the opening loss allowance balance under IAS 39 at December 31, 2017 and IFRS 9 at January 1, 2018. Comparative amounts for 2017 represent the allowance account for the loss allowance and reflect the measurement basis under IAS 39.

(000s)	31 Dec 2018			31 Dec 2017	
	Stage 1 12-month ECL	Stage 2 Lifetime ECL - not credit impaired loans	Stage 3 Lifetime ECL - credit- impaired loans	Total	Total
<b>Loss allowance on Personal Loans</b>					
<b>As at 1 Jan</b>	\$ 26	\$ 7	\$ 9	\$ 42	\$ 96
Amounts written off	-	-	(51)	(51)	(130)
Transfers to (from) Stage 1 - 12-month ECL	-	-	-	-	N/A
Transfers to (from) Stage 2 - Lifetime ECL - not credit-impaired loans	3	(3)	-	-	N/A
Transfers to (from) Stage 3 - Lifetime ECL - credit-impaired loans	-	1	(1)	-	N/A
Recoveries on loans previously written off	-	-	17	17	16
Allowance charged to (recovered from) operations	(19)	(1)	88	68	86
<b>As at 31 Dec</b>	\$ 10	\$ 4	\$ 62	\$ 76	\$ 68
<b>Loss allowance on Residential Mortgages</b>					
<b>As at 1 Jan</b>	\$ -	\$ 1	\$ 66	\$ 67	\$ 47
Amounts written off	-	-	(105)	(105)	(27)
Transfers to (from) Stage 1 - 12-month ECL	-	-	-	-	N/A
Transfers to (from) Stage 2 - Lifetime ECL - not credit-impaired loans	-	-	-	-	N/A
Transfers to (from) Stage 3 - Lifetime ECL - credit-impaired loans	-	-	-	-	N/A
Recoveries on loans previously written off	-	-	2	2	60
Allowance charged to (recovered from) operations	10	15	52	77	-
<b>As at 31 Dec</b>	\$ 10	\$ 16	\$ 15	\$ 41	\$ 80
<b>Total as at 31 Dec</b>	\$ 20	\$ 20	\$ 77	\$ 117	\$ 148

The 2017 individual allowance was \$80,000 and the collective allowance was \$68,000.

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**(ii) Credit-impaired financial assets**

The table below breaks down all credit-impaired financial assets by asset class under IFRS 9.

(000s)	31 Dec 2018			
	Gross carrying amount	Loss allowance	Carrying amount	
<b>Personal Loans</b>				
Stage 1 - 12-month ECL	\$ 14,941	\$ 10	\$	14,931
Stage 2 - Lifetime ECL - not credit-impaired loans	649	4		645
Stage 3 - Lifetime ECL - credit-impaired loans	263	62		201
	\$ 15,853	\$ 76	\$	15,777
<b>Residential Mortgages</b>				
Stage 1 - 12-month ECL	\$ 406,926	\$ 10	\$	406,916
Stage 2 - Lifetime ECL - not credit-impaired loans	11,009	16		10,993
Stage 3 - Lifetime ECL - credit-impaired loans	5,761	15		5,746
	\$ 423,696	\$ 41	\$	423,655
<b>Commercial Loans</b>				
Stage 1 - 12-month ECL	\$ 5,070	\$ -	\$	5,070
Stage 2 - Lifetime ECL - not credit-impaired loans	2,527	-		2,527
Stage 3 - Lifetime ECL - credit-impaired loans	-	-		-
	\$ 7,597	\$ -	\$	7,597
<b>Total</b>	<b>\$ 447,146</b>	<b>\$ 117</b>	<b>\$</b>	<b>447,029</b>

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**Maximum exposure to credit risk on financial instruments subject to impairment**

The following table contains an analysis of the maximum exposure to credit risk on financial instruments subject to impairment, based on past due information.

(000s)		31 Dec 2018			
Days Overdue	Stage 1 12-month ECL	Stage 2 Lifetime ECL - not credit- impaired loans	Stage 3 Lifetime ECL - credit-impaired loans	Total	
<b>Personal Loans</b>					
0 to 29 days	\$ 14,941	\$ 620	\$ 252	\$	15,813
30 to 89 days	-	29	5		34
90 days and greater	-	-	6		6
	\$ 14,941	\$ 649	\$ 263	\$	15,853
<b>Residential Mortgages</b>					
0 to 29 days	\$ 406,926	\$ 10,887	\$ 5,254	\$	423,067
30 to 89 days	-	122	371		493
90 days and greater	-	-	136		136
	\$ 406,926	\$ 11,009	\$ 5,761	\$	423,696
<b>Commercial Loans</b>					
0 to 29 days	\$ 5,070	\$ 2,527	\$ -	\$	7,597
30 to 89 days	-	-	-		-
90 days and greater	-	-	-		-
	\$ 5,070	\$ 2,527	\$ -	\$	7,597
<b>Total</b>	<b>\$ 426,937</b>	<b>\$ 14,185</b>	<b>\$ 6,024</b>	<b>\$</b>	<b>447,146</b>

**Comparative information under IAS 39**

The following table shows the balance of loans identified as impaired, prior to any recovery from collateral on these loans, as well as the carrying value of loans that are past due but not classified as impaired because they are either (i) less than 90 days past due, or (ii) less than 180 days past due and fully secured and collections efforts are reasonably expected to result in repayment.

(000s)		31 Dec 2017			
	Impaired	1-29 days	30-89 days	90 days and greater	Total
Personal loans	\$15	\$711	\$126	\$-	\$837
Residential mortgage loans	870	2,602	645	380	3,627
Commercial loans	-	-	-	-	-
	\$885	\$3,313	\$771	\$380	\$4,464

**(iii) Collateral**

Alterna Bank employs a range of policies and practices to mitigate credit risk, the most common of which is accepting collateral. A valuation of the collateral obtained is prepared as part of the loan origination process and reviewed

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periodically. The credit enhancements Alterna Bank holds as security for loans include (i) residential lots and properties, (ii) recourse to business assets such as real estate, equipment, inventory and accounts receivable, (iii) recourse to the commercial real estate properties being financed, and (iv) recourse to liquid assets, guarantees and securities. The policies regarding obtaining collateral have not significantly changed during the reporting period and there have been no significant changes in the overall quality of the collateral held since the prior period. Alterna Bank closely monitors collateral held for financial assets considered to be credit-impaired, as it becomes more likely Alterna Bank will take possession to mitigate potential credit losses. There were no repossessions held as at December 31, 2018 (2017 – \$888,000 residential mortgage loans repossessions).

**(iv) Loans with renegotiated terms**

Loans with renegotiated terms are defined as loans that have been restructured due to deterioration in the borrower’s financial position, for which Alterna Bank has made concessions by agreeing to terms and conditions that are more favorable for the borrower than Alterna Bank had provided initially and that it would not otherwise consider. A loan continues to be presented as part of loans with renegotiated terms until maturity, early repayment or write-off.

**b) MARKET RISK**

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises two types of risk: interest rate risk and currency risk.

**(i) Interest rate risk**

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Alterna Bank’s net income is exposed to interest rate risk because of the mismatches in maturities and interest rate types (fixed vs. variable) of its financial assets and financial liabilities.

Alterna Bank’s interest rate risk management objective is to maximize interest margin while complying with the approved interest rate risk policy limits. Alterna Bank uses derivatives such as interest rate swaps to manage interest rate risk.

Interest rate risk is managed in accordance with the Structural Risk Management Policy. This policy is reviewed and approved annually by the Board. Alterna Bank reports the interest rate risk against policy limits to the Asset Liability Committee (“ALCO”) on a monthly basis and the Board on a minimum quarterly basis.

Alterna Bank’s maximum tolerable exposure to short-term interest rate risk over 12 months is restricted to 5% of forecasted net interest income with a 95% confidence level. Its maximum tolerable exposure to interest rate risk on the entire balance sheets is restricted to a 4.5% decline in the market value of equity to mitigate long-term interest rate risk. As at December 31, 2018, the results for these measures were 1.84% (2017 – 0.98%) and 2.55% (2017 – 2.48%), respectively. Alterna Bank was in compliance with the policy as at December 31, 2018.

The following table details Alterna Bank’s exposure to interest rate risk resulting from the mismatch, or gap, between financial assets and financial liabilities. The financial instruments have been reported on the earlier of their contractual repricing date or maturity date from the date of purchase. Certain contractual repricing dates have been adjusted according to management’s estimates for prepayments and early redemptions. The weighted average interest rates shown represent historical rates for fixed-rate instruments carried at amortized cost and current market rates for variable-rate instruments or instruments carried at fair value. Derivatives are presented in the variable rate category.

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(000s)								31-Dec-18	31-Dec-17
Maturity									
	Non-interest rate sensitive	Variable rate demand	Under 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total	Total	
Cash and cash equivalents	\$ 33,572	\$ 5	\$ -	\$ -	\$ -	\$ -	\$ 33,577	\$ 18,725	
Interest Rates	-	-	-	-	-	-	-	0.23%	
Investments	\$ -	\$ -	\$ 7,556	\$ 22,448	\$ 22,341	\$ -	\$ 52,345	\$ 157,910	
Interest Rates	-	-	1.16%	1.53%	1.46%	-	1.45%	2.18%	
Personal loans	\$ -	\$ -	\$ 184	\$ 558	\$ 905	\$ 14,130	\$ 15,777	\$ 17,726	
Interest Rates	-	-	7.08%	7.08%	7.56%	5.01%	5.25%	4.60%	
Residential mortgage loans	\$ 8,197	\$ 335	\$ 85,256	\$ 100,408	\$ 480,980	\$ 1,119	\$ 676,295	\$ 484,599	
Interest Rates	-	-	3.08%	3.06%	3.09%	4.00%	3.04%	2.88%	
Commercial loans	-	\$ -	\$ 1,295	\$ 320	\$ 7,479	\$ 2,801	\$ 11,895	\$ 20,104	
Interest Rates	-	-	3.34%	4.96%	4.23%	2.99%	3.86%	4.46%	
Other	\$ 20,501	\$ 33	\$ -	\$ -	\$ -	\$ -	\$ 20,534	\$ 20,087	
<b>TOTAL ASSETS</b>	<b>\$ 62,270</b>	<b>\$ 373</b>	<b>\$ 94,291</b>	<b>\$ 123,734</b>	<b>\$ 511,705</b>	<b>\$ 18,050</b>	<b>\$ 810,423</b>	<b>\$ 719,151</b>	
Deposits	\$ -	\$ 473,656	\$ 14,329	\$ 91,870	\$ 91,453	\$ -	\$ 671,308	\$ 578,309	
Interest Rates	-	1.64%	1.94%	2.39%	2.20%	-	1.82%	1.68%	
Mortgage securitization liabilities	\$ -	\$ -	\$ -	\$ -	\$ 75,597	\$ -	\$ 75,597	\$ 83,609	
Interest Rates	-	-	-	-	2.35%	-	2.35%	2.14%	
Borrowings	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 4,499	
Interest Rates	-	-	-	-	-	-	-	2.52%	
Other	\$ 6,894	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 6,894	\$ 3,853	
Shareholders' equity	\$ 56,624	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 56,624	\$ 48,881	
<b>TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY</b>	<b>\$ 63,518</b>	<b>\$ 473,656</b>	<b>\$ 14,329</b>	<b>\$ 91,870</b>	<b>\$ 167,050</b>	<b>\$ -</b>	<b>\$ 810,423</b>	<b>\$ 719,151</b>	
<b>MATCHING GAP</b>	<b>-\$ 1,248</b>	<b>-\$ 473,283</b>	<b>\$ 79,962</b>	<b>\$ 31,864</b>	<b>\$ 344,655</b>	<b>\$ 18,050</b>	<b>\$ -</b>	<b>\$ -</b>	

(ii) **Sensitivity Analysis** - The key metrics that Alterna Bank uses to monitor interest rate risk are earnings at Risk (“EaR”) and Economic Value of Equity at Risk (“EVEaR”). This metric is calculated based on the balance sheet date and only represents cash flow risk. EaR is defined as the change in interest income from a predetermined shock to interest rates. This exposure is measured over a 12-month period. EVEaR is defined as the change in the present value of the asset portfolio resulting from a predetermined shock versus the change in the present value of the liability portfolio resulting from the same predetermined interest rate shock. To mitigate risk, Alterna Bank uses various derivative financial instruments to manage interest rate risk. The estimated impact of a 100 basis point shock on these metrics is presented below.

(000s)	31 Dec 2018	31 Dec 2017
EaR	(\$324)	(\$86)
EVEaR	(2.55%)	(2.48%)

(iii) **Currency risk**

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. Alterna Bank’s net income is exposed to currency risk because of clients’ US dollar deposits.

Alterna Bank mitigates currency risk by holding cash in US dollars. Currency risk is managed in accordance with the Structural Risk Management Policy. The policy is reviewed and approved annually by the Board.

Alterna Bank measures currency risk based on the percentage of foreign currency denominated financial assets against similar foreign currency denominated financial liabilities on a daily basis. As at December 31, 2018, the percentage of foreign currency denominated financial assets is within 90%–110% of foreign currency denominated financial liabilities.

For a 10% instantaneous exchange rate increase (decrease), Alterna Bank’s net income exposure is minimal.

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**c) LIQUIDITY RISK**

Liquidity risk is the risk that Alterna Bank will encounter difficulty in meeting obligations associated with financial liabilities. Alterna Bank is exposed to liquidity risk due to the mismatch in financial asset and financial liability maturities and the uncertainty of daily cash inflows and outflows.

Liquidity risk is managed in accordance with the Liquidity Management and Funding Policy. The policy is reviewed and approved annually by the Board. Alterna Bank manages liquidity risk by monitoring cash flows and cash forecasts, maintaining a pool of high quality liquid financial assets, maintaining a stable base of core and term deposits, monitoring concentration limits on single sources of deposits, and diversifying funding sources. Alterna Bank reports the liquidity risk against policy limits to ALCO on a monthly basis and to the Board on a minimum quarterly basis.

In May 2014, the Office of the Superintendent of Financial Institutions (“OSFI”) published the final Liquidity Adequacy Requirements (“LAR”) guideline. The LAR guideline is driven by the Basel Committee on Banking Supervision’s global liquidity guidelines which include the Liquidity Capital Ratio (“LCR”), Net Stable Funding Ratio (“NSFR”) and other intraday liquidity monitoring tools. It is further supplemented by a tool known as the Net Cumulative Cash Flow (“NCCF”) metric. Management uses the LAR and associated metrics to assess liquidity adequacy. The 100% minimum LCR requirement was effective January 1, 2015. In addition, NSFR and intraday liquidity monitoring tools reporting was effective January 1, 2018. Consistent with the guidelines above, Alterna Bank prepares the LCR and NCCF reports monthly and files the results with OSFI. As at December 31, 2018 and 2017, the LCR minimum was met and the NCCF did not show any liquidity deficiencies over the next 12-month period.

For the contractual maturities of assets and liabilities, please refer to the table under note 21.

The following table provides the maturity profile of financial liabilities based on the contractual repayment obligations, and excludes contractual cash flows related to derivative liabilities which are disclosed in note 21.

(000s)					31 Dec 2018	31 Dec 2017
	Less than 1 year	1 to 5 years	Over 5 years	No specified maturity	Total	Total
Deposits	\$106,199	\$91,453	\$-	\$473,656	\$671,308	\$578,309
Mortgage securitization liabilities	-	75,597	-	-	75,597	83,609
Borrowings	-	-	-	-	-	4,499
	<b>\$106,199</b>	<b>\$167,050</b>	<b>\$-</b>	<b>\$473,656</b>	<b>\$746,905</b>	<b>\$666,417</b>

**6. INVESTMENTS**

(000s)	31 Dec 2018	31 Dec 2017
Debt instrument securities designated as AFS (IAS 39)/ FVOCI (IFRS 9):		
Term deposits	\$-	\$101,038
Money market instruments	11,457	12,220
Equity instrument securities designated as AFS (IAS 39)/ FVOCI (IFRS 9):		
Other investments	390	60
Designated as FVTPL:		
Securities issued or guaranteed by Sovereigns*	40,498	44,592
	<b>\$52,345</b>	<b>\$157,910</b>

\*Sovereigns – Direct Obligations of the Government of Canada or any obligations directly guaranteed by the Government of Canada.

All of Alterna Bank’s investments were recorded at fair value. No impairments were recognized during 2018 or 2017.

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**7. PROPERTY AND EQUIPMENT**

(000s)	Furniture and Equipment	Leasehold Improvements	Total
<b>Cost:</b>			
Balance as at January 1, 2018	\$102	\$365	\$467
Additions	-	-	-
Disposals	-	-	-
<b>Balance as at December 31, 2018</b>	<b>102</b>	<b>365</b>	<b>467</b>
<b>Depreciation and impairment:</b>			
Balance as at January 1, 2018	84	348	432
Depreciation	4	12	16
Impairment losses	-	-	-
Disposals	-	-	-
<b>Balance as at December 31, 2018</b>	<b>88</b>	<b>360</b>	<b>448</b>
<b>Net book value:</b>			
Balance as at January 1, 2018	18	17	35
<b>Balance as at December 31, 2018</b>	<b>\$14</b>	<b>\$5</b>	<b>\$19</b>

(000s)	Furniture and Equipment	Leasehold Improvements	Total
<b>Cost:</b>			
Balance as at January 1, 2017	\$160	\$614	\$774
Additions	9	-	9
Disposals	(67)	(249)	(316)
<b>Balance as at December 31, 2017</b>	<b>102</b>	<b>365</b>	<b>467</b>
<b>Depreciation and impairment:</b>			
Balance as at January 1, 2017	143	588	731
Depreciation	5	9	14
Impairment losses	3	-	3
Disposals	(67)	(249)	(316)
<b>Balance as at December 31, 2017</b>	<b>84</b>	<b>348</b>	<b>432</b>
<b>Net book value:</b>			
Balance as at January 1, 2017	17	26	43
<b>Balance as at December 31, 2017</b>	<b>\$18</b>	<b>\$17</b>	<b>\$35</b>

Total depreciation charged to income in 2018 was \$16,000 (2017 – \$14,000) and is included in administration and occupancy expenses on the statements of income.

Impairment losses on property and equipment are recorded within administration and occupancy expenses under operating expenses on the statements of income.

The gross carrying amount of fully depreciated property and equipment that are still in use is \$392,000 as at December 31, 2018 (December 31, 2017 – \$364,000).

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**8. INTANGIBLE ASSETS**

(000s)	Computer Software 2018	Computer Software 2017
<b>Cost:</b>		
Balance as at January 1	\$1,362	\$618
Additions	187	744
Disposals	-	-
<b>Balance as at December 31</b>	<b>1,549</b>	1,362
<b>Depreciation and impairment:</b>		
Balance as at January 1	332	125
Depreciation	626	207
Impairment losses	-	-
Disposals	-	-
<b>Balance as at December 31</b>	<b>958</b>	332
<b>Net book value:</b>		
Balance as at January 1	1,030	493
<b>Balance as at December 31</b>	<b>\$591</b>	\$1,030

Total amortization charged to income in 2018 was \$626,000 (2017 – \$207,000) and is included in administration expenses on the statements of income. All computer software assets have been acquired not developed.

**9. OTHER ASSETS**

(000s)	31 Dec 2018	31 Dec 2017
Securitization receivables and deferred charges	\$13,649	\$11,647
Accrued interest receivable	1,640	2,169
Prepaid expenses and other deferred charges	3,943	1,825
Receivable from parent company	-	1,629
Other	67	1,086
	<b>\$19,299</b>	\$18,356

**10. DEPOSITS**

(000s)	31 Dec 2018	31 Dec 2017
Demand deposits	\$473,633	\$373,961
Term deposits	79,580	122,344
Registered plans	118,095	82,007
	<b>\$671,308</b>	\$578,312

As at December 31, 2018, Alterna Bank held US dollar deposits from clients of US\$22,100,090 (December 31, 2017 – US\$355,000) with a carrying amount of \$30,137,893 (December 31, 2017 – \$446,000).

**11. BORROWINGS**

(000s)	31 Dec 2018	31 Dec 2017
Borrowings	\$-	\$2,879
Repurchase agreements	-	1,620
	<b>\$-</b>	\$4,499

Alterna Bank has access to a \$30,000,000 credit facility with Central 1 Credit Union (“Central 1”) (2017 – \$30,000,000). The credit facility is guaranteed by Alterna Bank’s parent company, Alterna Savings and Credit Union Limited (“Alterna Savings”). There was \$nil outstanding balance against these facilities at the end of the year (December 31, 2017 – \$nil).

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Alterna Bank also has access to a \$25,000,000 revolving credit facility with the Canadian Imperial Bank of Commerce (2017 – \$25,000,000) through its parent company Alterna Savings of which the balance outstanding was \$nil as at December 31, 2018 (2017 – \$2,879,000). The facility is secured by insured mortgage collateral.

Borrowings also includes \$nil (2017 – \$1,620,000) in short-term borrowings in the form of investment repurchase agreements entered into with Central 1.

**12. MORTGAGE SECURITIZATION LIABILITIES**

<b>(000s)</b>	<b>31 Dec 2018</b>	31 Dec 2017
Mortgage securitization liabilities	<b>\$75,597</b>	\$83,609

As part of its program of liquidity, capital and interest rate risk management, Alterna Bank secures funding for its growth by entering into mortgage securitization arrangements.

Alterna Bank securitizes single-family and multi-unit insured mortgages into mortgage-backed securities (“MBS”) and in turn sells the MBS to third parties or Canada Housing Trust (“CHT”). CHT is financed through the issuance of CMBs, which are sold to third party investors under the Canada Mortgage Bond Program. The creation of MBS does not lead to the derecognition of the underlying mortgages as Alterna Bank has retained substantially all the risks and rewards of ownership. However, during the year, Alterna Bank also securitized and sold the MBS of certain insured multi-unit residential mortgages with no prepayment privileges. These mortgages were effectively derecognized as a result of these transactions as there was no prepayment or credit risk associated with the sold MBS.

Alterna Bank has entered into certain transactions which allow the transfer of the contractual right to receive the residual cash flows from the mortgages and transfer substantially all of the risks and rewards of ownership, including credit, interest rate, prepayment and other price risks. In these cases, the mortgages are derecognized from the balance sheets as described in note 2(g)(iii). The present value of the future residual cash flows is recorded on the balance sheets under other assets. If the criteria are not met, the mortgages remain on the books and a secured borrowing is recorded with respect to any consideration received. Refer to note 18 for income generated from securitization activity.

<b>(000s)</b>	<b>31 Dec 2018</b>	31 Dec 2017
Mortgages securitized:		
On-balance sheet (and included in loans)	<b>\$195,817</b>	\$99,724
Off-balance sheet	<b>565,790</b>	325,229

**13. OTHER LIABILITIES**

<b>(000s)</b>	<b>31 Dec 2018</b>	31 Dec 2017
Trade payables and accrued expenses	<b>\$1,798</b>	\$1,564
Accrued interest payable	<b>1,893</b>	1,335
Due to parent company	<b>497</b>	-
	<b>\$4,188</b>	\$2,899

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**14. LEASES**

**OPERATING LEASE OBLIGATIONS**

The future minimum lease payments required under Alterna Bank's operating leases were as follows:

<b>(000s)</b>	<b>31 Dec 2018</b>	31 Dec 2017
<b>Future minimum lease payments</b>		
Within one year	<b>\$29</b>	\$31
From one to five years	-	29
Later than five years	-	-
<b>Total future minimum lease payments</b>	<b>\$29</b>	\$60

During 2018, \$58,000 was recognized as an expense, under occupancy expenses in the statements of income in respect of operating leases (2017 – \$82,000).

All operating leases have options for renewal, at which time all terms are renegotiated.

**15. SHARE CAPITAL**

The authorized share capital of Alterna Bank consists of an unlimited number of common shares, which have standard voting rights.

As at December 31, 2018, there were 4,000,001 (2017 – 3,500,001) common shares issued and outstanding: 4,000,000 (2017 – 3,500,000) with a stated value of \$10 per share and one common share with a stated value of \$1 per share. During 2018, Alterna Bank's parent company subscribed to an additional 500,000 common shares at \$10 per share. There are no issued shares that have not been fully paid.

**16. INTEREST INCOME AND INTEREST EXPENSE**

<b>(000s)</b>	<b>31 Dec 2018</b>	31 Dec 2017
Interest income:		
Personal loans	<b>\$814</b>	\$746
Residential mortgage loans	<b>16,210</b>	5,838
Commercial loans	<b>570</b>	1,447
Swaps	<b>63</b>	48
	<b>\$17,657</b>	\$8,079
Interest expense:		
Demand deposits	<b>\$6,877</b>	\$5,398
Term deposits	<b>1,349</b>	1,369
Registered plans	<b>2,327</b>	1,250
Borrowings	<b>13</b>	6
Mortgage securitization cost of funds	<b>3,908</b>	1,936
	<b>\$14,474</b>	\$9,959

No interest income was recorded on Stage 3 loans (IFRS 9) / impaired loans (IAS 39) for the years ended December 31, 2018 and 2017, as they were 100% provisioned.

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**17. INVESTMENT INCOME**

(000s)	31 Dec 2018	31 Dec 2017
Income on financial assets fair value through profit and loss	\$512	\$681
Income on financial assets available-for-sale	2,085	4,172
	<b>\$2,597</b>	<b>\$4,853</b>

**18. SECURITIZATION INCOME**

(000s)	31 Dec 2018	31 Dec 2017
Net gain on sale of mortgages <sup>1</sup>	\$1,834	\$2,980
Net change in unrealized gain or loss on hedging activities	9	(177)
Servicing income	176	103
	<b>\$2,019</b>	<b>\$2,906</b>

<sup>1</sup> Gain on sale of mortgages is net of hedging impact.

The hedging activities included in the above table hedge interest rate risk on loans held for sale. The derivatives, which are bond forwards, are not designated in hedge accounting relationships. The gains or losses on the derivatives are mainly offset by the fair value change in the loans held for sale.

**19. INCOME TAXES**

The significant components of the deferred income tax asset (liability) of Alterna Bank are as follows:

(000s)	31 Dec 2018	31 Dec 2017
Loss allowance	\$27	\$20
Derivatives	217	(69)
Property and equipment	60	(11)
Investments	237	48
Other	51	18
	<b>\$592</b>	<b>\$6</b>
<b>On Balance sheets:</b>		
Deferred income tax asset	\$592	\$399
Deferred income tax liability	-	(393)
Net deferred income tax asset	<b>\$592</b>	<b>\$6</b>

The reconciliation of income tax computed at the statutory rates to income tax expense is as follows:

(000s)	31 Dec 2018		31 Dec 2017	
	Amount	Percent	Amount	Percent
Expected tax provision at combined federal and provincial rates	\$1,271	27%	\$590	27%
Rate differential	2	-%	(1)	-%
Other - net	-	-%	55	2%
	<b>\$1,273</b>	<b>27%</b>	<b>\$644</b>	<b>29%</b>

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The components of income tax expense for the years ended December 31, 2018 and 2017 are as follows:

(000s)	31 Dec 2018	31 Dec 2017
	Amount	Amount
Current tax		
Current income tax	\$1,585	\$749
Deferred income tax		
Relating to the origination and reversal of timing differences	(312)	(105)
<b>Income tax expense reported in the statements of income</b>	<b>\$1,273</b>	<b>\$644</b>

The tax related to items charged to OCI during the year is as follows:

(000s)	31 Dec 2018	31 Dec 2017
Change in unrealized gains and losses on available-for-sale financial assets (IAS 39)/ FVOCI (IFRS 9)	(\$297)	\$151
Change in gains and losses on derivatives designated as cash flow hedges	4	(26)
	(\$293)	\$125

The current and deferred income tax charged or credited to other comprehensive income (loss) during the year is as follows:

(000s)	31 Dec 2018	31 Dec 2017
Current income tax	(\$22)	(\$89)
Deferred income tax	271	214
	(\$293)	\$125

There are no tax related contingent liabilities and contingent assets as at December 31, 2018 in accordance with IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*.

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**20. FAIR VALUE OF FINANCIAL INSTRUMENTS**

The amounts set out in the table below represent the estimated fair values of the financial instruments of Alterna Bank for each classification of financial instrument, including the fair values of loans calculated before the loss allowance, using the valuation methods and assumptions described below.

(000s)	31 Dec 2018		31 Dec 2017	
	Carrying value	Fair value	Carrying value	Fair value
<b>Financial assets:</b>				
Available-for-sale (IAS 39)/ FVOCI (IFRS 9):				
Investments	\$52,345	\$52,345	\$157,910	\$157,910
Fair value through profit and loss:				
Derivative financial instruments				
- purchased options	20	20	47	47
- interest rate swaps	13	13	-	-
- bond forwards	-	-	612	612
Loans and advances				
- residential mortgage loans	252,640	252,640	132,441	132,441
- commercial loans	4,298	4,298	7,283	7,283
Loans and receivables (IAS 39)/ Amortized cost (IFRS 9):				
Cash and cash equivalents	33,577	33,577	18,725	18,725
Loans and advances				
- personal loans	15,853	15,862	17,794	17,910
- residential mortgage loans	423,696	434,478	352,239	359,452
- commercial loans	7,597	7,950	12,821	13,094
<b>TOTAL ASSETS</b>	<b>\$790,039</b>	<b>\$801,183</b>	<b>\$699,872</b>	<b>\$707,474</b>
<b>Financial liabilities:</b>				
Other liabilities:				
Deposits				
- demand deposits	\$473,633	\$473,633	\$373,961	\$373,961
- term deposits	79,580	79,594	122,344	120,486
- registered plans	118,095	118,189	82,007	81,919
Mortgage securitization liabilities	75,597	77,651	83,609	84,702
Fair value through profit and loss:				
Derivative financial instruments				
- interest rate swaps	97	97	56	56
- embedded options	20	20	47	47
- bond forwards	1,785	1,785	207	207
<b>TOTAL LIABILITIES</b>	<b>\$1,220,538</b>	<b>\$750,969</b>	<b>\$666,730</b>	<b>\$665,877</b>

Management has assessed that cash and cash equivalents, trade receivables, trade payables and other current liabilities approximate their carrying amounts largely due to the short-term maturities of these instruments.

IFRS 13, *Fair Value Measurement*, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (i.e., an exit price). The following methods and assumptions were used to estimate the fair values:

(i) Fair values of AFS/FVOCI investments are derived from discounted cash flow valuation models. Discount rates are based on observable market inputs, other than quoted prices, which include relevant interest rates pertaining to the value of the investments.

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(ii) Alterna Bank enters into derivative financial instruments with various counterparties, principally financial institutions with investment grade credit ratings. Derivatives valued using valuation techniques include purchased and embedded options. The most frequently applied valuation technique includes present value calculations. The models incorporate various inputs including the credit quality of counterparties and interest rate curves. As at December 31, 2018, the marked-to-market value of derivative asset positions is net of a credit valuation adjustment attributable to derivative counterparty default risk. The changes in counterparty credit risk had no material effect on other financial instruments recognized at fair value. Alterna Bank also takes into account the counterparties' non-performance risks (for the purchased options) or its own non-performance risk (for the embedded derivative liabilities). As at December 31, 2018, Alterna Bank assessed these risks to be insignificant.

(iii) Personal loans, residential mortgage loans, commercial loans and deposits - at discounted cash flows using prevailing interest rates of instruments with similar remaining terms. The fair values of all types of loans are calculated before any loss allowance.

**FAIR VALUE HIERARCHY**

The following tables show the hierarchical classification of financial assets and financial liabilities measured or disclosed at fair value as at December 31, 2018 and 2017:

<b>December 31, 2018</b>	<b>(000s)</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>Assets measured at fair value:</b>					
Financial investments FVOCI		\$-	\$52,345	\$-	\$52,345
Derivative financial instruments					
- purchased options		-	20	-	20
- interest rate swaps		-	13	-	13
- bond forwards		-	-	-	-
Loans and advances					
- residential mortgage loans		-	252,640	-	252,640
- commercial loans		-	4,298	-	4,298
<b>Assets for which fair values are disclosed:</b>					
Loans and advances					
- personal loans		-	-	15,862	15,862
- residential mortgage loans		-	-	434,478	434,478
- commercial loans		-	-	7,950	7,950
<b>Liabilities measured at fair value:</b>					
Derivative financial instruments					
- interest rate swap		-	97	-	97
- embedded options		-	20	-	20
- bond forwards		-	1,785	-	1,785
<b>Liabilities for which fair values are disclosed:</b>					
Deposits					
- demand deposits		-	-	473,633	473,633
- term deposits		-	-	79,594	79,594
- registered plans		-	-	118,189	118,189
Mortgage securitization liabilities		-	-	77,651	77,651

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December 31, 2017	(000s)	Level 1	Level 2	Level 3	Total
<b>Assets measured at fair value:</b>					
Financial investments AFS		\$-	\$157,910	\$	\$157,910
Derivative financial instruments					
- purchased options		-	47	-	47
- bond forwards		-	612	-	612
Loans and advances					
- residential mortgage loans		-	132,441	-	132,441
- commercial loans		-	7,283	-	7,283
<b>Assets for which fair values are disclosed:</b>					
Loans and advances					
- personal loans		-	-	17,910	17,910
- residential mortgage loans		-	-	359,452	359,452
- commercial loans		-	-	13,094	13,094
<b>Liabilities measured at fair value:</b>					
Derivative financial instruments					
- interest rate swap		-	56	-	56
- embedded options		-	47	-	47
- bond forwards		-	207	-	207
<b>Liabilities for which fair values are disclosed:</b>					
Deposits					
- demand deposits		-	-	373,961	373,961
- term deposits		-	-	120,486	120,486
- registered plans		-	-	81,919	81,919
Mortgage securitization liabilities		-	-	84,702	84,702

There were no transfers between Level 1 and Level 2 for the years ended December 31, 2018 and 2017.

**21. DERIVATIVE FINANCIAL INSTRUMENTS**

The tables below provide a summary of Alterna Bank's derivative portfolio, their notional values and fair values as at December 31, 2018 and 2017:

(000s)	Maturities of derivatives (Notional amounts)			Fair Value	
	Within 1 Year	1 to 5 Years	Total	Derivative	Derivative
				Instrument Assets	Instrument Liabilities
<b>Interest rate contracts</b>					
Swaps	\$5,000	\$40,000	\$45,000	\$13	\$97
Bond forwards	158,400	-	158,400	-	1,785
<b>Other derivatives</b>					
Index-linked call options	375	175	550	20	20
	<b>\$163,775</b>	<b>\$40,175</b>	<b>\$203,950</b>	<b>\$33</b>	<b>\$1,902</b>

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(000s)				31 Dec 2017	
	Maturities of derivatives (Notional amounts)			Fair Value	
	Within 1 Year	1 to 5 Years	Total	Derivative Instrument Assets	Derivative Instrument Liabilities
Interest rate contracts					
Swaps	\$-	\$20,000	\$20,000	\$-	\$56
Bond forwards	215,300	-	215,300	612	206
Other derivatives					
Index-linked call options	175	519	694	47	48
	\$215,475	\$20,519	\$235,994	\$659	\$310

The notional amounts are used as the basis for determining payments under the contracts and are not actually exchanged between Alterna Bank and its counterparties. They do not represent credit risk exposure.

**a) INTEREST RATE CONTRACTS**

**Bond forwards**

As part of its interest rate risk management process, Alterna Bank utilizes bond forwards to maintain its interest rate exposure on forecasted debt issuance associated with securitization activity. Realized gains (losses) on these derivatives are recorded in other income.

**b) OTHER DERIVATIVES**

**Swaps**

Alterna Bank uses interest rate swap agreements to mitigate risks associated with interest rate fluctuations and to control the matching of the cash flow maturities and interest adjustment dates of its assets and liabilities.

Designated cash flow hedges are interest rate swap agreements which qualify as hedging relationships for accounting purposes under IAS 39. All other interest rate swap agreements are classified as economic hedges. Alterna Bank has designated certain hedging relationships involving interest rate swaps that convert variable rate loans to fixed rate loans as cash flow hedges.

Interest rate swap agreements are valued by netting the discounted variable and fixed cash flows. Variable cash flows are calculated using implied interest rates as determined by current Canadian Dealer Offered Rate ("CDOR") and swap interest rates, and term relationships. Fixed cash flows are calculated based on the rates stated in the agreements. These notional cash flows are discounted using the relevant points on the zero interest curve plus a Credit Value Adjustment spread as derived from the month-end CDOR and swap rates.

**Index-linked call options**

Alterna Bank has issued \$550,000 of indexed term deposits to its clients as at December 31, 2018 (2017 – \$694,000). These term deposits have maturities of three or five years at issuance and pay interest to the depositors, at the end of the term, based on the performance of the S&P/TSX60 Index. Alterna Bank uses purchased call options on the above indices with equivalent maturities to offset the exposure associated with these products. Alterna Bank pays a premium amount based on the notional amount at the inception of the equity index-linked option contract. At the end of the term, Alterna Bank receives from the counterparties payments equal to the amount that will be paid to the depositors based on the performance of the respective indices.

**c) CREDIT EXPOSURE**

OSFI accounting guideline D-6 *Derivatives Disclosure* requires all federally regulated financial institutions including banks to disclose the positive replacement cost, credit equivalent amount and the risk-weighted equivalent by class of derivative instrument. Alterna Bank had the following derivatives bearing a positive replacement cost as at December 31:

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<b>December 31, 2018</b>			
<b>(000s)</b>	<b>Replacement Cost</b>	<b>Credit Equivalent Amount</b>	<b>Risk-Weighted Amount</b>
Bond forwards	\$-	\$-	\$-
Purchased options	21	57	11
Swaps	13	213	43
	<b>\$34</b>	<b>\$270</b>	<b>\$54</b>

  

<b>December 31, 2017</b>			
<b>(000s)</b>	<b>Replacement Cost</b>	<b>Credit Equivalent Amount</b>	<b>Risk-Weighted Amount</b>
Bond forwards	\$612	\$612	\$122
Purchased options	47	100	20
Swaps	-	100	20
	<b>\$659</b>	<b>\$812</b>	<b>\$162</b>

Replacement cost represents the cost of replacing all contracts that have a positive fair value, using current market rates. It represents in effect the unrealized gains on Alterna Bank’s derivative instruments.

Credit equivalent amount represents the total replacement cost plus an amount representing the potential future credit exposure, as outlined in OSFI’s Capital Adequacy Guideline.

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

**22. CAPITAL MANAGEMENT**

Alterna Bank’s capital management objective is to ensure the long-term viability of the company and the security of client deposits by holding a level of capital deemed sufficient to protect against unanticipated losses and to comply with the capital requirements set out in the *Bank Act* (the “Act”) and OSFI regulations. Alterna Bank defines capital to include share capital, retained earnings, and certain elements of AOCI.

Alterna Bank manages its capital in accordance with the Capital Management Policy, which is reviewed and approved annually by the Board.

The policy requires Alterna Bank to hold capital at levels higher than these OSFI-required minimums:

Leverage ratio	3%
Common equity tier 1 (“CET1”) ratio	7%
Tier 1 capital ratio	8.5%
Total capital ratio	10.5%

In addition, Alterna Bank established an Internal Capital Adequacy Assessment Process (“ICAAP”) and provided capital for major enterprise risks in addition to those required by the Act.

The processes for managing capital include setting policies for capital management, monitoring and reporting, setting policies for related areas such as asset liability management, reporting to the Board regarding financial results and capital adequacy, and setting budgets and reporting variances to those budgets.

Total capital includes Tier 1 and Tier 2 capital, net of certain deductions. Tier 1 capital represents more permanent forms of capital, and includes CET1 capital less deductions required under Basel III. CET1 capital primarily includes common shareholder’s equity and preferred shares. Tier 2 capital is typically comprised of subordinated debentures and the eligible portion of the general loss allowance. The Tier 1 Capital Ratio and Total Capital Ratio are the primary capital measures monitored by Alterna Bank’s regulator.

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The Tier 1 Capital Ratio is defined as Tier 1 capital divided by risk-weighted assets. The Total Capital Ratio is defined as total capital divided by risk-weighted assets.

Basel III regulatory capital and risk-weighted assets are as follows:

	<b>31 Dec 2018</b>	31 Dec 2017
CET1 capital (000s)	<b>\$56,624</b>	\$48,881
Tier 1 capital (000s)	<b>\$56,624</b>	\$48,881
Tier 2 capital (000s)	<b>\$40</b>	\$-
Total capital (000s)	<b>\$56,664</b>	\$48,881
Total risk-weighted assets (000s)	<b>\$163,550</b>	\$156,849
CET1 capital ratio	<b>34.6%</b>	31.2%
Tier 1 capital ratio	<b>34.6%</b>	31.2%
Total capital ratio	<b>34.6%</b>	31.2%

As at December 31, 2018, Alterna Bank's leverage ratio was 6.96% (2017 – 6.77%). Alterna Bank was in compliance with policy, the Act and regulations regarding the leverage ratio and total capital as a percent of risk-weighted assets. In addition, Alterna Bank complied with these requirements throughout the year.

**23. COMMITMENTS AND CONTINGENCIES**

**a) CREDIT INSTRUMENTS**

As at December 31, 2018, the credit instruments approved but not yet disbursed were as follows:

<b>(000s)</b>	<b>Total</b>
Residential mortgage loans	<b>\$890</b>
Lines of credit unfunded	<b>\$25,831</b>

**b) CONTINGENCIES**

In the normal course of operations, Alterna Bank becomes involved in various claims and legal proceedings. While the final outcome with respect to claims and legal proceedings pending as at December 31, 2018 cannot be predicted with certainty, it is the opinion of management that their resolution will not have a material adverse effect on Alterna Bank's financial position or results of operations.

**c) INDEMNIFICATION AGREEMENTS**

In the normal course of its operations, Alterna Bank provides indemnification agreements to counterparties in certain transactions such as purchase contracts, service agreements and sales of assets. These indemnification agreements require Alterna Bank to compensate the counterparties for costs incurred as a result of changes in laws and regulations (including tax legislation) or as a result of litigation claims or statutory sanctions that may be suffered by the counterparty as a consequence of the transaction. Alterna Bank also 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 or officers. The terms of these indemnification agreements vary based on the contract. The nature of the indemnification agreements prevents Alterna Bank from making a reasonable estimate of the maximum potential amount it could be required to pay to counterparties. Historically, Alterna Bank has not made any significant payments under such indemnification agreements. No amount has been accrued with respect to these indemnification agreements.

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**24. NOTES TO STATEMENTS OF CASH FLOWS**

**a) COMPONENTS OF CASH AND CASH EQUIVALENTS**

(000s)	31 Dec 2018	31 Dec 2017
Cash on hand	\$437	\$125
Deposits with other financial institutions	33,140	18,600
<b>Total</b>	<b>\$33,577</b>	<b>\$18,725</b>

**b) CASH FLOWS PRESENTED ON A NET BASIS**

Cash flows arising from loan advances and repayments, client deposits and withdrawals have been presented on a net basis in the statements of cash flows.

**25. RELATED PARTY TRANSACTIONS**

Parties are considered to be related if one party has the ability to directly or indirectly control the other party or exercise significant influence over the other party in making financial or operational decisions. Alterna Bank's related parties include:

- key management personnel, close family members of key management personnel and entities which are controlled, significantly influenced by, or for which significant voting power is held by key management personnel or their close family members; and
- its parent company, Alterna Savings.

Alterna Bank has several business relationships with related parties. Transactions with such parties are made in the ordinary course of business on substantially the same terms, including interest rates and collateral, as those prevailing at the time of comparable transactions with other parties. These transactions also did not involve more than the normal risk of collectability or present other unfavourable features.

Restrictions on the potential distribution of cash dividends or loan repayments by Alterna Bank to Alterna Savings are determined by regulatory requirements. The potential maximum amount of dividend that can be distributed amounted to \$32,227,000 and \$27,219,000 as at December 31, 2018 and 2017 respectively.

**a) TRANSACTIONS WITH KEY MANAGEMENT PERSONNEL**

Key management personnel ("KMP") are those persons having authority and responsibility for planning, directing and controlling the activities of the bank, directly or indirectly, including any director (whether executive or otherwise) of that entity. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Alterna Bank considers the members of its Board of Directors and the members of the executive management to constitute KMP for purposes of IAS 24, *Related Party Disclosures*. Executive management includes the President & CEO as well as employees in positions titled Vice-President, Senior Vice-President, or Region Head.

**(i) Key management personnel compensation**

The aggregate compensation of KMP directly charged to Alterna Bank during the year comprising amounts paid or payable or provided for was as follows:

(000s)	31 Dec 2018	31 Dec 2017
Short-term employee benefits	\$44	\$43
Post-employment benefits	-	-
Other long-term employee benefits	-	-
Termination benefits	-	-
<b>Total KMP compensation</b>	<b>\$44</b>	<b>\$43</b>

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During 2018 and during 2017, KMP were not directly compensated by Alterna Bank as they are employees of the parent, Alterna Savings.

**(ii) Loans to KMP**

<b>(000s)</b>	<b>31 Dec 2018</b>	31 Dec 2017
<b>(1) Aggregate value of loans outstanding as at balance sheets date</b>	<b>\$790</b>	\$846
<b>(2) Total value of personal lines of credit facilities as at balance sheets date</b>	-	-
Less: Amounts drawn down and included in loan values and included in (1)	-	-
<b>Net balance available</b>	<b>\$790</b>	\$846
<b>Aggregate value of loans disbursed during the year:</b>		
Residential mortgages	\$-	\$-
Personal loans	-	-
<b>Total</b>	<b>\$-</b>	\$-

**(iii) Deposits from KMP**

<b>(000s)</b>	<b>31 Dec 2018</b>	31 Dec 2017
Total value of demand, term and registered plans deposits from KMP	<b>\$1,073</b>	\$819
Total amount of interest paid on deposits to KMP	<b>15</b>	4

**b) MANAGEMENT SERVICES AGREEMENT**

Alterna Bank, by contract with its parent company, Alterna Savings, makes payments for costs incurred and services rendered relating to the management and administration of Alterna Bank. The management fee charged for 2018 was \$2,543,000 (2017 – \$1,743,000) and is included under salaries and benefits and administration expenses. Transactions are recorded in accordance with the agreement negotiated between both entities.

At the end of the year, Alterna Bank owed \$497,000 to Alterna Savings (2017 – Alterna Savings owed Alterna Bank \$1,629,000).

**c) INVESTMENTS**

As at December 31, 2018, investments included term deposits and securities issued or guaranteed by Sovereigns issued by Alterna Savings in the amount of \$40,499,000 (2017 – \$145,630,000). Accrued interest receivable as at December 31, 2018 was \$40,000 (2017 – \$947,000) and is included in other assets. The investments bear a weighted average interest rate of 1.16% (2017 – 2.22%) and mature in 2021. The interest incurred on these deposits during the year totalled \$2,160,000 (2017 – \$4,462,000).

**d) DEPOSITS**

As at December 31, 2018, deposits included demand deposits issued to Alterna Savings in the amount of \$57,240,000 (2017 – \$1,472,000) and term deposits in the amount of \$nil (2017 – \$55,055,000). Accrued interest payable as at December 31, 2018 was \$nil (2017 – \$20,000) and is included in other liabilities. The term deposits were redeemed during the year. The interest incurred on these deposits during the year totalled \$99,000 (2017 – \$275,000).

**e) LOANS**

As at December 31, 2018, loans included mortgages purchased from Alterna Savings in the amount of \$51,124,000 (2017 – \$63,038,000). During the year, \$14,976,000 (2017 – \$nil) of mortgages were sold to Alterna Savings and \$nil (2017 – \$76,661,000) of loans were purchased from Alterna Savings.

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**f) MORTGAGE SECURITIZATION LIABILITIES**

As at December 31, 2018, mortgage securitization liabilities included MBS sold to Alterna Savings in the amount of \$64,000 (2017 – \$72,000). During the year, \$nil (2017 – \$60,612,000) MBS were purchased from Alterna Savings.

**26. SELECTED DISCLOSURES**

**a) 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, 2018 and 2017.

(000s)	As at December 31, 2018			As at December 31, 2017		
	Within 1 year	After 1 year	Total	Within 1 year	After 1 year	Total
<b>Assets</b>						
Cash and cash equivalents	\$33,577	\$-	\$33,577	\$18,725	\$-	\$18,725
Investments	30,004	22,341	52,345	60	157,850	157,910
Personal loans	817	15,036	15,853	17,197	597	17,794
Residential mortgages	194,237	482,099	676,336	147,634	337,046	484,680
Commercial loans	1,615	10,280	11,895	14,436	5,668	20,104
Loss allowance	(117)	-	(117)	(148)	-	(148)
Property and equipment	-	19	19	-	35	35
Intangible assets	-	591	591	-	1,030	1,030
Derivative financial instruments	17	16	33	630	29	659
Deferred income tax asset	-	592	592	-	6	6
Other assets	19,299	-	19,299	18,356	-	18,356
<b>Total assets</b>	<b>\$279,449</b>	<b>\$530,974</b>	<b>\$810,423</b>	<b>\$216,890</b>	<b>\$502,261</b>	<b>\$719,151</b>
<b>Liabilities</b>						
Demand deposits	\$473,633	\$-	\$473,633	\$373,961	\$-	\$373,961
Term deposits	63,687	15,893	79,580	49,530	72,814	122,344
Registered plans	42,535	75,560	118,095	73,801	8,206	82,007
Mortgage securitization liabilities	-	75,597	75,597	-	83,609	83,609
Borrowings	-	-	-	4,499	-	4,499
Derivative financial instruments	1,802	100	1,902	-	310	310
Income tax payable	804	-	804	641	-	641
Other liabilities	4,188	-	4,188	2,899	-	2,899
<b>Total liabilities</b>	<b>\$586,649</b>	<b>\$167,150</b>	<b>\$753,799</b>	<b>\$505,331</b>	<b>\$164,939</b>	<b>\$670,270</b>
<b>Net</b>	<b>(\$307,200)</b>	<b>\$363,824</b>	<b>\$56,624</b>	<b>(\$288,441)</b>	<b>\$337,322</b>	<b>\$48,881</b>

**27. EVENTS AFTER THE BALANCE SHEETS DATE**

There have been no events subsequent to the balance sheets date that would have a material effect on Alterna Bank's financial statements as at December 31, 2018.

**28. COMPARATIVE AMOUNTS**

Certain 2017 comparative amounts have been reclassified to conform to the financial statement presentation adopted in 2018. In 2018, securitization activity was moved from financing activities to operating activities on the statements of cash flows. Also in 2018, within the statement of income there is a new line under other income called securitization income which includes net gain on sale of mortgages, net change in unrealized gain or loss on hedging activities and servicing income (see details in note 18). In 2017, net change in unrealized gain or loss in hedging activities was part of net gains on derivative financial instruments under other income and servicing income was part of other under other income. Net gain on sale of mortgages was part of other income in 2017 and 2018. Furthermore, deposits were moved to level 3 from

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level 2 in the fair value hierarchy table in 2018 (see note 20). The statements of income, statements of cash flows and related notes to the financial statements for 2017 comparative purposes have been updated accordingly.