HomeEquity Bank™

# BASEL III PILLAR 3 DISCLOSURES

## December 31, 2024

## Overview

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

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

## Basis of preparation

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

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

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

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

## Overview of Risk Management

The Enterprise Risk Management Framework ("ERMF") sets out the Bank's governance model and overarching approach to identify, assess, mitigate, monitor and report on risk. The ERMF ensures that the Bank's risks and risk exposures are effectively identified, measured, assessed, managed, monitored and reported relative to the Bank's Board-approved Risk Appetite Framework ("RAF").

The Bank management is committed to effectively managing the risks, with a focus on generating sustained value for the Bank's shareholders, clients, employees, and the communities the Bank serves. Risk management is a fundamental competency of the Bank, underpinned by a culture deeply attuned to risk and a comprehensive, proactive risk management framework. The Bank's approach to risk is dynamic, evolving in response to the rapid pace of change within the financial services landscape.

## KM1: Key Metrics (at consolidated group level)

| | | **Dec 31, 2024** | **Sep 30, 2024** | **Jun 30, 2024** | **Mar 31, 2024** | **Dec 31, 2023** |
|---|---|---|---|---|---|---|
| | **Available capital (amounts)** | | | | | |
| 1 | Common Equity Tier 1 (CET1) | **584,285** | 551,361 | 535,243 | 523,470 | 508,241 |
| 2 | Tier 1 | **584,285** | 551,361 | 535,243 | 523,470 | 508,241 |
| 3 | Total capital | **622,017** | 587,326 | 571,964 | 558,944 | 543,133 |
| | **Risk-weighted assets (amounts)** | | | | | |
| 4 | Total risk-weighted assets (RWA) | **3,728,553** | 3,577,785 | 3,363,972 | 3,234,438 | 3,112,160 |
| | **Risk-based capital ratios as a percentage of RWA** | | | | | |
| 5 | CET1 ratio (%) | **15.7%** | 15.4% | 15.9% | 16.2% | 16.3% |
| 6 | Tier 1 ratio (%) | **15.7%** | 15.4% | 15.9% | 16.2% | 16.3% |
| 7 | Total capital ratio (%) | **16.7%** | 16.4% | 17.0% | 17.3% | 17.5% |
| | **Additional CET1 buffer requirements as a percentage of RWA** | | | | | |
| 8 | Capital conservation buffer requirement (2.5% from 2019) (%) | **2.5%** | 2.5% | 2.5% | 2.5% | 2.5% |
| 9 | Countercyclical buffer requirement (%) | **n/a** | n/a | n/a | n/a | n/a |
| 10 | Bank G-SIB and/or D-SIB additional requirements (%) | **n/a** | n/a | n/a | n/a | n/a |
| 11 | Total of bank CET1 specific buffer requirements (%) (row 8 + row 9 + row 10) | **2.5%** | 2.5% | 2.5% | 2.5% | 2.5% |
| 12 | CET1 available after meeting the bank's minimum capital requirements (%) | **8.7%** | 8.4% | 8.9% | 9.2% | 9.3% |
| | **Basel III Leverage ratio** | | | | | |
| 13 | Total Basel III leverage ratio exposure measure | **9,271,464** | 8,940,944 | 8,362,503 | 8,087,773 | 7,852,523 |
| 14 | Basel III leverage ratio (row 2 / row 13) | **6.30%** | 6.17% | 6.40% | 6.47% | 6.47% |

## CC1: Composition of HomeEquity Bank Capital

| *(in thousands of Canadian dollars)* | | **Dec 31, 2024** |
|---|---|---|
| | **Common Equity Tier 1 capital: instruments and reserves** | |
| 1 | Directly issued qualifying common share capital (and equivalent for non-joint stock companies) plus related stock surplus | 220,513 |
| 2 | Retained earnings | 366,467 |
| 6 | **Common Equity Tier 1 capital before regulatory adjustments** | 586,980 |
| | **Common Equity Tier 1 capital: regulatory adjustments** | |
| 28 | Total regulatory adjustments to Common Equity Tier 1 | (2,695) |
| 29 | Common Equity Tier 1 capital (CET1) | 584,285 |
| | **Additional Tier 1 capital: regulatory adjustments** | |
| 44 | **Additional Tier 1 capital (AT1)** | 0 |
| 45 | **Tier 1 capital (T1 = CET1 + AT1)** | 584,285 |
| | **Tier 2 capital: instruments and provisions** | |
| 50 | Eligible Stage 1 and Stage 2 allowance | 37,732 |
| 51 | **Tier 2 capital before regulatory adjustments** | 37,732 |
| | **Tier 2 capital: regulatory adjustments** | |
| 57 | **Total regulatory adjustments to Tier 2 capital** | 0 |
| 58 | **Tier 2 capital (T2)** | 37,732 |
| 59 | **Total capital (TC = T1 + T2)** | 622,017 |
| 60 | **Total risk weighted assets** | 3,728,553 |
| | **Capital ratios** | |
| 61 | Common Equity Tier 1 (as a percentage of risk weighted assets) | 15.7% |
| 62 | Tier 1 (as a percentage of risk weighted assets) | 15.7% |
| 63 | Total capital (as a percentage of risk weighted assets) | 16.7% |
| | **OSFI target** | |
| 69 | Common Equity Tier 1 capital target ratio | 7.0% |
| 70 | Tier 1 capital target ratio | 8.5% |
| 71 | Total capital target ratio | 10.5% |

## LR2: Leverage Ratio Common Disclosure Template

| | *(in thousands of Canadian dollars)* | Dec 31, 2024 | Sep 30, 2024 |
|---|---|---|---|
| | **On-balance sheet exposures** | | |
| 1 | On-balance sheet items (excluding derivatives, SFTs and grandfathered securitization exposures but including collateral) | **9,129,180** | 8,796,044 |
| | | | |
| 2 | Gross-up for derivatives collateral provided where deducted from balance sheet assets pursuant to the operative accounting framework (IFRS) | | |
| 3 | (Deductions of receivable assets for cash variation margin provided in derivatives transactions) | | |
| 4 | (Asset amounts deducted in determining Tier 1 capital) | **(2,695)** | (2,836) |
| 5 | **Total on-balance sheet exposures (excluding derivatives and SFTs) (sum of lines 1 to 4)** | **9,126,485** | 8,793,208 |
| | **Derivative exposures** | | |
| 6 | Replacement cost associated with all derivative transactions | **18,987** | 20,436 |
| 7 | Add-on amounts for PFE associated with all derivative transactions | **11,529** | 12,734 |
| 8 | (Exempted CCP-leg of client cleared trade exposures) | | |
| 9 | Adjusted effective notional amount of written credit derivatives | | |
| 10 | (Adjusted effective notional offsets and add-on deductions for written credit derivatives) | | |
| 11 | **Total derivative exposures (sum of lines 6 to 10)** | **30,516** | 33,170 |
| | **Other off-balance sheet exposures** | | |
| 17 | Off-balance sheet exposure at gross notional amount | **286,156** | 286,416 |
| 18 | (Adjustments for conversion to credit equivalent amounts) | **(171,693)** | (171,850) |
| 19 | **Off-balance sheet items (sum of lines 17 and 18)** | **114,463** | 114,566 |
| | **Capital and total exposures** | | |
| 20 | **Tier 1 Capital** | **584,285** | 551,361 |
| 21 | **Total Exposures (sum of lines 5, 11, 16 and 19)** | **9,271,464** | 8,940,944 |
| | **Leverage ratio** | | |
| 22 | **Basel III leverage ratio** | **6.30%** | 6.17% |

## CRA: Credit Risk General Qualitative Disclosure

Credit risk is the potential for financial loss if a borrower or counterparty in a transaction fails to meet its obligations in accordance with agreed terms. This risk is typically associated with the possibility of default by an obligor.

The Bank’s maximum exposure to non-derivative credit risk is represented by its consolidated balance sheet’s values for cash resources, securities, residential reverse mortgages, and other assets. Credit risk on the Bank’s cash resources are mitigated by maintaining cash balances at highly rated Schedule I Canadian chartered banks.

The Board is ultimately responsible for risk oversight, with credit risk management shared across the three lines of defense. The Board-approved credit risk appetite is embedded within monitoring practices and is overseen by the Conduct and Risk Review Management Committee (CRRMC), which supports the Board in fulfilling its responsibilities. Additionally, a management-level committee (Credit Committee) ensures alignment with the Board's expectations and approved policies. The Bank regularly monitors its risks, assessments, and related action plans, providing senior management and the Board with information that allows them to monitor the effectiveness of the risk management process and activities.

### a) Translating the Business Model into the Bank’s Credit Risk Profile

The Bank’s core business involves origination and management of reverse mortgages. As a provider of this product, the Bank’s business model creates a distinct credit risk profile, influenced by exposure to the residential real estate market and a borrower base consisting of homeowners aged 55 and better. Unlike conventional mortgage products, reverse mortgages present distinct risks, including potential declines in property values, interest rate volatility that may affect projected equity at loan maturity, and loan durations linked to the borrower’s longevity and mobility.

HomeEquity Bank uses a proprietary lending model to estimate the timing of mortgage repayment based on the age and gender of the borrower. This information, along with property value assessments and geographic diversification information is used to determine the loan amount.

Risk management is further strengthened through robust policies governing loan-to-value ratios, initial appraisal and re-appraisal of property values and default management. The initial appraised value is subsequently discounted, typically by between 5% and 30%. This disciplined approach ensures that the Bank's credit risk profile strikes an effective balance between its strategic emphasis on reverse mortgage products and its commitment to mitigating risks arising from real estate market volatility and borrower longevity which have resulted in low historical losses.

### b) Criteria and Approach for Defining Credit Risk Management Policy and Setting Credit Risk Limits

The Bank's credit policy and credit risk limits are established based on a structured approach, aligning with regulatory guidelines, strategic objectives, and risk appetite. Key criteria used in defining the policy include:

- **Regulatory Requirements**: Policies are developed to comply with regulations, ensuring the Bank meets minimum standards for credit exposure, capital adequacy, and risk management practices.
- **Risk Appetite**: The Board-approved risk appetite serves as a foundation, guiding acceptable levels of risk based on the bank's tolerance for credit exposure and its broader risk strategy. This ensures that credit practices align with the bank's overall objectives and the risk-return balance.
- **Market and Economic Conditions**: Current and anticipated economic trends, industry risks, and market conditions are considered when setting policy criteria and credit limits. This helps the Bank manage risks in volatile environments and adjust exposure levels in response to changing conditions.
- **Portfolio Diversification Goals**: Policies and limits are designed to support diversification across geographies, thereby reducing concentration risk.
- **Borrower Quality and Creditworthiness**: Criteria for borrower assessment, such as credit scores, financial strength, and capacity to meet their property obligations, influence policy and limit-setting to maintain a high-quality loan portfolio.
- **Historical Performance and Data Analytics**: Data of historical loan performance and credit losses inform policy adjustments and limit setting, allowing the bank to refine its approach based on experience and trends in default rates.

### c) Structure and Organization of the Credit Risk Management and control function

The credit risk oversight function is structured to ensure comprehensive oversight and effective mitigation of credit risk across the Bank's portfolio. It operates within a robust framework, aligning with the three lines of defense governance model to promote clear accountability and effective risk management.

- **Credit Risk Management Department**: Under the leadership of the Chief Risk Officer (CRO), the Credit Risk Management function executes the credit risk strategy through specific policies, risk limits, and controls established by the CRRMC and/ or by the Board. The function, led by the VP, Credit Risk, has the capability to identify, measure, and manage credit risk across relevant product(s). The team leverages analytics, comprehensive risk assessment, and portfolio management practices to ensure a cohesive and integrated approach to managing credit risk effectively.

  Acting as the second line of defense, the credit risk function monitors compliance with credit policy and guidelines, independently assessing credit exposures and adherence to established risk limits. It escalates any deviations to senior management for timely corrective actions.
- **Independent Review and Audit**: The Internal Audit function serves as the third line of defense, conducting periodic reviews and reports its findings to the Board and the CRRMC.

- **Reporting and Communication**: Regular reporting channels ensure transparency and accountability in credit risk management. The CRRMC receives periodic update on credit exposures, portfolio performance, enabling it to make informed decisions and address related emerging risks.

This structured organization enables the Bank to manage credit risk effectively, ensuring alignment with its risk appetite, compliance with regulatory standards, and resilience against credit-related losses.

The Board-approved credit risk appetite is supported by designated risk approval authorities and limits, which are delegated by the Board to senior management. To facilitate day-to-day operations, senior management has further delegated certain authorities onward within the organization. Reportable exceptions are escalated to the CRRMC and/ or the Board itself, as outlined in the approved credit policy, ensuring effective oversight and adherence to governance.

### d) Relationships between the Credit Risk Management, Compliance and Internal Audit functions

The Credit Risk Management work collaboratively to create a well-coordinated approach to managing and monitoring credit risk, each bringing unique perspectives and responsibilities to the governance framework.

- The **Credit Risk Management** function holds the responsibility for implementing Board-approved credit risk policies, limits, and monitoring practices. Within this function, independent oversight is exercised to ensure adherence to risk standards and address any risk breaches, promoting alignment with both business expectations and regulatory requirements. This integrated approach supports a cohesive and authentic execution of credit risk management, maintaining operational efficiency and adherence to the intended risk framework.
- The **Compliance** function provides guidance to Credit Risk Management on regulatory requirements.
- **Internal Audit** serves as the third line of defense by conducting independent assessments of the Credit Risk Management activities. It evaluates the effectiveness of risk policies, compliance with risk limits, and overall alignment with the bank's credit risk appetite.
- **Cross-Function Communication**: Regular and structured communication between these functions is essential to effective governance. Credit Risk Management, Compliance, and Internal Audit maintain clear reporting lines, allowing for timely updates on risk exposures, regulatory changes, and audit findings. This collaboration ensures that all functions are well-informed and capable of addressing emerging risks and regulatory requirements cohesively.

### e) Scope of Credit Risk Reporting

Senior management, CRRMC and the Board receive regular reports on credit risk, covering, portfolio composition and quality, portfolio performance metrics such as geographical spread and LTV breakdown, adherence to risk appetite, significant changes to risk strategy, and stress testing outcomes. Additional relevant metrics are included to monitor material risks effectively as required.

## ORA: Operational Risk General Qualitative Disclosure

Operational risk refers to the risk of loss resulting from inadequate or failed internal processes, people, systems, or external events.

### a) Policies, Frameworks and Guidelines for the Management of Operational Risk

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

### b) Structure and Organisation of the Bank's Operational Risk Management

The Bank's operational risk management is structured to support a robust framework for identifying, assessing, monitoring, and controlling operational risks across all areas of the organization. This structure is grounded in the three lines of defense model, which delineates responsibilities to ensure effective risk oversight and management.

- **First Line of Defense**: Business units and operational staff are the primary owners of risk. They are responsible for identifying and managing risks within their operations by implementing controls and adhering to risk management policies. This proactive risk management approach ensures that operational risk is recognized and addressed at the source.

- **Second Line of Defense**: The Risk Management teams provide oversight, guidance, and support to business units. They are responsible for developing risk frameworks, policies, and procedures that align with regulatory standards and best practices. These teams conduct independent risk assessments, monitor adherence to risk controls, and provide advisory support to the first line of defense. Additionally, they report key risk indicators and operational risk metrics to ensure transparency and accountability.

- **Third Line of Defense:** The Internal Audit function offers independent assurance over the effectiveness of the Bank's operational risk management framework.

This organizational structure promotes a coordinated and enterprise-wide approach to operational risk management, ensuring that roles and responsibilities are clear and that all departments work together to mitigate risk. The Bank's commitment to maintaining an effective operational risk management framework enables it to respond swiftly to internal and external risk factors, enhancing resilience and safeguarding the Bank's reputation.

### c) Operational Risk Measurement

The Bank uses the simplified standardized approach to compute operational risk in its risk-weighted assets. Under this approach, the Bank holds capital for operational risk equal to 15% of average annual adjusted gross income over the previous 12 fiscal quarters.

This regulatory approach supplemented by the Internal Capital Adequacy Assessment Process assessment ensures that sufficient capital is maintained to cover potential operational risk losses, bolstering the Bank's resilience against unforeseen disruptions.

### d) Scope of the Bank's Operational Risk Reporting

The Board, both directly or through its committees, reviews and approves Bank policies, and implements specific reporting procedures to enable it to monitor the Bank's operational risk profile and ensure compliance with the Board-approved RAF.

The Bank's operational risk reporting framework is designed to ensure that key operational risk concerns are identified, monitored, and addressed proactively. Regular reporting of Key Risk Indicators (KRIs), incidents and issues highlights potential risk areas, enabling timely interventions and fostering a risk-aware culture across the organization.

Operational risk matters are discussed and reviewed by the Operational Risk Management Committee (ORMC), with regular updates provided to executive management. Significant risk concerns, along with mitigation actions and trends, are escalated to the CRRMC, ensuring that operational risk remains a priority at the highest levels of governance.

This proactive approach towards operational risk management enables executive management and the Board to stay informed of the Bank's operational risk landscape, supporting effective oversight and governance to manage operational risk proactively across all business areas.

### e) Operational Risk Mitigation and Transfer Strategies

The Bank employs a comprehensive approach to mitigate and manage operational risk, fostering a resilient risk management framework that supports financial stability and alignment with strategic objectives.

The Bank has established a robust risk framework with policies and procedures aimed at mitigating identified operational risks. Key policies, including those addressing enterprise-wide operational risk, risk appetite, third-party risk and technology risk guide risk management activities across the organization. These policies reinforce a culture of accountability and sound decision-making, ensuring that operational risks are managed effectively across all levels of the Bank.

By adapting to emerging risks and evolving regulatory requirements, the Bank continually strengthens its ability to mitigate operational risks and maintain a resilient operating environment.

## MRA: Market Risk General Qualitative Disclosure

Market risk refers to the impact of market price fluctuations on our financial condition, including potential gains or losses resulting from changes in market-driven variables such as interest rates, credit spreads, equity prices, commodity prices, foreign exchange rates, and implied volatilities.

The Bank does not engage in trading or investment activities that result in exposure to market risk. The Bank has no trading desk and purchases securities and engages in derivative trades purely as part of the banking book for purposes of investing excess cash and hedging banking book interest rate risk, respectively.

## CVAA: Credit Valuation Assessment General Qualitative Disclosure

Credit Valuation Adjustment (CVA) risk arises from potential losses due to changes in the credit risk of a counterparty in derivative transactions, which can impact the valuation of such positions. Effective management of CVA risk is essential to maintain financial stability, particularly in relation to over-the-counter (OTC) derivatives. To address CVA risk, the Bank follows the Basic Approach (BA) as prescribed by regulatory guidelines. The BA approach provides a standardized method for calculating CVA capital requirements, ensuring that the Bank maintains sufficient capital to offset potential losses associated with counterparty credit risk.

### a) Processes for Identifying, Measuring, Monitoring, and Controlling CVA Risks

The Bank's CVA exposure is minimal, due to a lack of trading book and derivatives contracts limited to hedging of interest rate risk in the banking book. CVA risks are identified by assessing counterparty credit exposures in derivative transactions and potential valuation impacts of creditworthiness changes. Measurement is conducted using the Basic Approach (BA), ensuring a standardized calculation of CVA capital requirements.

Given the limited exposure, CVA risks are monitored periodically through simplified reporting at the netting set level and adherence to counterparty credit limits. Mitigation measures, such as collateral agreements, are applied as needed, with oversight tailored to reflect the minimal exposure while maintaining compliance and sound governance practices.

### b) Capital Requirement for CVA Risk

The Bank calculates capital requirements for CVA risk using the Basic Approach (BA), ensuring a standardized and regulatory-compliant method for estimating capital needs. As part of its prudent approach, the Bank transacts with only large investment-grade financial institutions, minimizing exposure to credit valuation risks. Use of the BA approach ensures sufficient capital is allocated proportionate to the minimal CVA exposure, aligning with sound risk management practices and regulatory expectations.

## CVA1: The reduced basic approach for CVA (BA-CVA)

| | | a | b |
|---|---|---|---|
| | | Components | Capital requirements under BA-CVA |
| 1 | **Aggregation of systematic components of CVA risk** [1] | 739,654 | 480,775 |
| 2 | **Aggregation of idiosyncratic components of CVA risk** [2] | 859,290 | 558,538 |
| 3 | **Total** [3] | 1,598,944 | 1,039,313 |

1. Aggregation of systematic components of CVA risk: Capital requirements under perfect correlation assumption (∑cSCVAc) as per [CAR 2024, Chapter 8, paragraph 14].
2. Aggregation of idiosyncratic components of CVA risk: Capital requirements under zero correlation assumption (sqrt(∑cSCVAc2)) as per [CAR 2024, Chapter 8, paragraph 14].
3. Total: DS-BA-CVA x Kreduced as per [CAR 2024, Chapter 8, paragraph 14].

## CVA2: The full basic approach for CVA (BA-CVA)

| | | a |
|---|---|---|
| | | Capital requirements under BA-CVA |
| 1 | **K Reduced** [1] | 1,039,313 |
| 2 | **K Hedged** [2] | - |
| 3 | **Total** [3] | 1,039,313 |

1. K Reduced: DS-BA-CVA x Kreduced as per [CAR 2024, Chapter 8, paragraph 14].
2. K Hedged: DS-BA-CVA x Khedged as per [CAR 2024, Chapter 8, paragraph 21].
3. Total: DS-BA-CVA x Kfull as per [CAR 2024, Chapter 8, paragraph 20].