Consolidated financial statements

First National Financial Corporation

December 31, 2018 and 2017

Independent auditor's report

To the Shareholders of
First National Financial Corporation

Opinion

We have audited the consolidated financial statements of First National Financial Corporation and its subsidiaries (collectively the Company), which comprise the consolidated statement of financial position as at December 31, 2018 and December 31, 2017, and the consolidated statements of income, comprehensive income, changes in equity and cash flows for the years then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects the consolidated financial position of the Company as at December 31, 2018 and December 31, 2017, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards (IFRSs).

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 Consolidated Financial Statements* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada, and we have fulfilled our ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Information

Management is responsible for the other information. The other information comprises:

- Management's Discussion and Analysis
- The information, other than the consolidated financial statements and our auditor's report thereon, in the Annual Report

Our opinion on the consolidated financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon. In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

We obtained Management's Discussion and Analysis prior to the date of this auditor's report. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact in this auditor's report. We have nothing to report in this regard.

The Annual Report is expected to be made available to us after the date of the auditor's report. If, based on the work we will perform on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact to those charged with governance.

Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements

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

In preparing the consolidated financial statements, management is responsible for assessing the Company'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 the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated 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 consolidated 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 consolidated 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 the Company'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 the Company'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 consolidated 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 the Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure, and content of the consolidated financial statements, including the disclosures, and whether the consolidated 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 the Company to express an opinion on the consolidated 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.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this independent auditor's report is Andre de Haan.

Ernst & Young LLP

Chartered Professional Accountants
Licensed Public Accountants

Toronto, Canada
February 25, 2019

First National Financial Corporation

Consolidated statements of financial position

[in thousands of Canadian dollars]

As at December 31

	2018	2017
	$	$
Assets		
Restricted cash *[note 3]*	**577,096**	561,470
Cash held as collateral for securitization *[note 3]*	**75,913**	66,413
Accounts receivable and sundry	**150,668**	144,159
Securities purchased under resale agreements *[note 15]*	**2,188,149**	2,185,362
Mortgages accumulated for sale or securitization *[note 5]*	**2,204,886**	1,789,765
Mortgages pledged under securitization *[note 3]*	**30,567,036**	27,566,677
Deferred placement fees receivable *[note 4]*	**41,584**	41,273
Mortgage and loan investments *[note 6]*	**188,666**	379,713
Income taxes recoverable *[note 19]*	**3,982**	—
Other assets *[note 7]*	**39,147**	41,446
Total assets	**36,037,127**	32,776,278
Liabilities and equity		
Liabilities		
Bank indebtedness *[note 9]*	**918,347**	643,828
Obligations related to securities and mortgages sold under repurchase agreements *[note 15]*	**1,262,395**	1,200,135
Accounts payable and accrued liabilities *[note 16]*	**124,451**	118,081
Securities sold short *[note 14]*	**2,183,411**	2,180,253
Debt related to securitized and participation mortgages *[note 10]*	**30,762,651**	27,834,080
Senior unsecured notes *[note 12]*	**174,829**	174,693
Income taxes payable *[note 18]*	**—**	7,191
Deferred tax liabilities *[note 18]*	**78,800**	74,750
Total liabilities	**35,504,884**	32,233,011
Equity attributable to shareholders		
Common shares *[note 17]*	**122,671**	122,671
Preferred shares *[note 17]*	**97,394**	97,394
Retained earnings	**315,294**	323,202
Accumulated other comprehensive income	**(3,116)**	—
Total equity	**532,243**	543,267
	36,037,127	32,776,278

See accompanying notes

On behalf of the Board:

John Brough

Robert Mitchell

First National Financial Corporation

Consolidated statements of comprehensive income

[in thousands of Canadian dollars, except earnings per share]

Years ended December 31

	2018	2017
	$	$
Revenue		
Interest revenue – securitized mortgages	**790,192**	658,783
Interest expense – securitized mortgages	**(646,069)**	(511,939)
Net interest – securitized mortgages *[note 3]*	**144,123**	146,844
Placement fees	**141,887**	144,589
Gains on deferred placement fees *[note 4]*	**11,747**	10,020
Mortgage investment income	**88,325**	68,276
Mortgage servicing income	**146,197**	140,841
Realized and unrealized gains on financial instruments *[note 19]*	**3,162**	56,259
	535,441	566,829
Expenses		
Brokerage fees	**75,354**	83,260
Salaries and benefits	**99,735**	97,824
Interest	**69,949**	46,428
Other operating	**62,986**	53,915
	308,024	281,427
Income before income taxes	**227,417**	285,402
Income tax expense *[note 18]*	**60,990**	75,750
Net income for the year	**166,427**	209,652
Net income attributable to:		
Shareholders	**166,427**	208,078
Non-controlling interests	**—**	1,574
	166,427	209,652
Earnings per share		
Basic *[note 17]*	**2.73**	3.42

See accompanying notes

First National Financial Corporation

Consolidated statements of comprehensive income

[in thousands of Canadian dollars]

Years ended December 31

	2018	2017
	$	$
Net income for the period	**166,427**	209,652
Other comprehensive income items		
that may be subsequently reclassified to income		
Net gains from change in fair value of cash flow hedges	**3,210**	—
Reclassification of net gains to income	**(7,466)**	—
	(4,256)	—
Income tax recovery	**1,140**	—
Total other comprehensive income	**(3,116)**	—
Total comprehensive income	**163,311**	209,652

First National Financial Corporation

Consolidated statements of changes in equity

[in thousands of Canadian dollars]

Years ended December 31

	Common shares	Preferred shares	Retained earnings	Accumulated other comprehensive income	Total equity
	$	$	$	$	$
Balance as at January 1, 2018	**122,671**	**97,394**	**323,202**	**—**	**543,267**
Net income	**—**	**—**	**166,427**	**—**	**166,427**
Other comprehensive income, net of tax	**—**	**—**	**—**	**(3,116)**	**(3,116)**
Dividends paid or declared	**—**	**—**	**(174,335)**	**—**	**(174,335)**
Balance as at December 31, 2018	**122,671**	**97,394**	**315,294**	**(3,116)**	**532,243**

	Common shares	Preferred shares	Retained earnings	Non-controlling interest	Total equity
	$	$	$	$	$
Balance as at January 1, 2017	122,671	97,394	302,271	27,961	550,297
Comprehensive income	—	—	208,078	1,574	209,652
Dividends paid or declared	—	—	(187,147)	(1,535)	(188,682)
Redemptions by non-controlling interests	—	—	—	(28,000)	(28,000)
Balance as at December 31, 2017	122,671	97,394	323,202	—	543,267

First National Financial Corporation

Consolidated statements of cash flows

[in thousands of Canadian dollars]

Years ended December 31

	2018	2017
	$	$
Operating activities		
Net income for the year	**166,427**	209,652
Add (deduct) items		
Deferred income tax expense	**5,190**	11,650
Non-cash portion of gains on deferred placement fees	**(11,298)**	(9,452)
Decrease (increase) in restricted cash	**(15,626)**	123,877
Net investment in mortgages pledged under securitization	**(3,000,359)**	(1,485,325)
Net increase in debt related to securitized mortgages	**2,928,894**	1,325,674
Provision for loan loss	**—**	2,740
Amortization of deferred placement fees receivable	**10,987**	11,082
Amortization of purchased mortgage servicing rights	**—**	664
Amortization of property, plant and equipment	**4,931**	5,135
Unrealized losses (gains) on financial instruments	**25,157**	(23,254)
	114,303	172,443
Net change in non-cash working capital balances related to operations	**(425,261)**	21,865
Cash provided by (used in) operating activities	**(310,958)**	194,308
Investing activities		
Additions to property, plant and equipment	**(2,632)**	(4,249)
Investment of cash held as collateral for securitization	**(9,500)**	(43,536)
Investment in mortgage and loan investments	**(400,701)**	(475,129)
Repayment of mortgage and loan investments	**587,748**	347,906
Cash provided by (used in) investing activities	**174,915**	(175,008)
Financing activities		
Dividends paid	**(174,031)**	(188,066)
Obligations related to securities and mortgages sold under repurchase agreements	**62,260**	190,563
Decrease in debt related to participation mortgages	**(323)**	(5,775)
Securities purchased under resale agreements, net	**(2,787)**	(877,561)
Securities sold short, net	**(23,595)**	874,233
Redemption by non-controlling interests	**—**	(28,000)
Cash used in financing activities	**(138,476)**	(34,606)
Net increase in bank indebtedness during the year	**(274,519)**	(15,306)
Bank indebtedness, beginning of year	**(643,828)**	(628,522)
Bank indebtedness, end of year	**(918,347)**	(643,828)
Supplemental cash flow information		
Interest received	**941,551**	794,240
Interest paid	**668,301**	531,799
Income taxes paid	**66,973**	80,163

First National Financial Corporation

Notes to consolidated financial statements

[in thousands of Canadian dollars, unless otherwise indicated]

December 31, 2018 and 2017

1. General organization and business of first national financial corporation

First National Financial Corporation [the "Corporation" or "Company"] is the parent company of First National Financial LP ["FNFLP"], a Canadian-based originator, underwriter and servicer of predominantly prime residential [single family and multi-unit] and commercial mortgages. With over $106 billion in mortgages under administration as at December 31, 2018, FNFLP is a significant participant in the mortgage broker distribution channel.

The Corporation is incorporated under the laws of the Province of Ontario, Canada and has its registered office and principal place of business located at 100 University Avenue, Toronto, Ontario. The Corporation's common and preferred shares are listed on the Toronto Stock Exchange under the symbols FN, FN.PR.A and FN.PR.B, respectively.

2. Significant accounting policies

[a] Basis of preparation

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ["IFRS"]. The consolidated financial statements have been prepared on a historical cost basis, except for derivative financial instruments and financial assets and financial liabilities that are recorded at fair value through profit or loss ["FVTPL"] and measured at fair value. The carrying values of recognized assets and liabilities that are designated as hedged items in fair value hedges, and that would otherwise be carried at amortized cost, are adjusted to record changes in fair value attributable to the risks that are being in effective hedge relationships. The consolidated financial statements are presented in Canadian dollars and all values are rounded to the nearest thousand except when otherwise indicated. The consolidated financial statements were authorized for issue by the Board of Directors on February 25, 2019.

[b] Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiaries, including FNFLP, First National Financial GP Corporation ["GP", the general partner of FNFLP], FNFC Trust, a special purpose entity ["SPE"] which is used to manage undivided co-ownership interests in mortgage assets funded with Asset-Backed Commercial Paper ["ABCP"], First National Asset Management Inc. ["FNAM"], and First National Mortgage Corporation. The 2017 comparative financial information includes the financial statements of First National Mortgage Investment Fund [the "Fund"] and FN Mortgage Investment Trust [the "Trust"] until their termination on December 19, 2017.

FNAM is wholly-owned subsidiary of the GP, and an indirect subsidiary of the Company. FNAM is a NHA approved lender and NHA-MBS issuer in the capacity of an "aggregator". Its business model is to purchase mortgages from arms-length mortgage originators in order to create NHA-MBS pools, and subsequently sell these into the Canada Mortgage Bonds programs ["CMB"]. In 2018, FNAM issued three NHA-MBS pools totaling $85 million.

The Fund and the Trust were created in 2012 as special purpose vehicles to obtain exposure to a diversified portfolio of high yielding mortgages. Pursuant to the trustee's determination, both the Fund and the Trust were terminated on December 19, 2017. While the Fund and Trust operated, because of its status as the sole seller of assets to the Fund and its rights as promoter, the Company determined that it had de facto control of both the Fund and the Trust, and therefore, consolidated the operations and net assets of the Fund and the Trust until termination. Non-controlling interests in the Fund and the Trust were shown as a separate component of equity on the consolidated statements of financial position to distinguish them from the equity of the Company's shareholders. The net income attributable to non-controlling interests is also separately disclosed on the consolidated statements of comprehensive income. On termination, the Company effectively purchased the interest in the Fund and Trust from the non-controlling interests.

The Company did not consolidate, in its financial statements, three SPEs over which the Company does not have control. The SPEs are sponsored by third-party financial institutions which acquire assets from various sellers including mortgages from the Company. The Company earns interest income from the retained interest related to these mortgages. As at December 31, 2018, the Company recorded, on its consolidated statements of financial position, its portion of the assets of the SPEs amounting to $801 million [2017 – $800 million]. The Company also recorded, in its consolidated statements of comprehensive income, interest revenue – securitized mortgages of $27.9 million [2017 – $8.2 million] and interest expense – securitized mortgages of $22.3 million [2017 – $7.7 million] related to its interest in the SPEs.

The consolidated financial statements have been prepared using consistent accounting policies for like transactions and other events in similar circumstances. All intercompany assets and liabilities, equity, income, expenses and cashflows relating to transactions between these companies are eliminated in full on consolidation.

[c] Use of estimates

The preparation of consolidated financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, including contingencies, at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results may differ from those estimates. Major areas requiring use of estimates by management are those that require reporting of financial assets and financial liabilities at fair value.

[d] Significant accounting policies

Financial Instruments

On January 1, 2018, the Company adopted IFRS 9 – *Financial Instruments* ["IFRS 9"]. As permitted by the transition provisions of IFRS 9, the Company elected not to restate comparative period results. All comparative period information is presented in accordance with the accounting policies as described in the annual consolidated financial statements for the year ended December 31, 2017.

Classification and measurement of financial assets

IFRS 9 requires that all financial assets are measured at either fair value through profit or loss ["FVTPL"], fair value through OCI ["FVOCI"], or amortized cost, based on the contractual cash flow characteristics of the financial assets and the business model under which the financial assets are managed.

The Company originates and underwrites single-family residential mortgages and multi-unit residential commercial mortgages. Subsequent to origination, the mortgages are either placed with third party investors [mortgages accumulated for sale] or securitized through various securitization vehicles [mortgages accumulated for securitization]. When mortgages are securitized, typically they do not meet de-recognition criteria, and continue to be held on the Company's balance sheet as mortgages pledged under securitization.

The Company also invests in commercial bridge mortgages and other miscellaneous loans using its own internal funding sources. These assets are classified as FVTPL and are presented as mortgage and loan investments on its consolidated statement of financial position.

Based on its business models as described above, the Company has determined the classification of its financial assets as below:

	IFRS 9	**IAS 39**
Securities purchased under resale agreement	Amortized Cost	Amortized Cost
Mortgages accumulated for securitization	Amortized Cost	Loans and Receivables
Mortgages accumulated for sale	FVTPL	FVTPL
Mortgages pledged under securitization	Amortized Cost	FVTPL or Loan and Receivables
Mortgage and loan investments	FVTPL	Loans and Receivable
Deferred placement fees receivable	Amortized Cost	FVTPL

As at December 31, 2017, the difference resulting from the change in accounting classification of the assets was insignificant; accordingly, no adjustment to opening retained earnings was recorded.

Classifications and measurement of financial liabilities

The Company classifies its financial liabilities as either amortized cost or at FVTPL as summarized below:

	IFRS 9	**IAS 39**
Obligations related to securities and mortgages sold under repurchase agreements	FVTPL	FVTPL
Securities sold short	FVTPL	FVTPL
Debt related to securitized mortgages	Amortized Cost	Amortized Cost
Servicing liabilities	Amortized Cost	Amortized Cost
Senior unsecured notes	Amortized Cost	Amortized Cost

Impairment

IFRS 9 introduces an expected credit loss ["ECL"] impairment model applicable to all debt instruments within financial assets classified as amortized cost or FVOCI, as well as certain off-balance sheet loan commitments. Prior to January 1, 2018, credit losses were recognized under an incurred loss model. The IFRS 9 ECL approach has three stages: Stage 1 – the credit risk has not increased significantly since initial recognition such that an allowance for credit loss is recognized and maintained equal to 12 months of expected credit loss; Stage 2 – the credit risk has increased significantly since initial recognition, and the allowance for credit loss is increased to cover full lifetime expected credit loss; and Stage 3 – a financial asset is considered credit-impaired and the allowance for credit loss continues to be the full lifetime expected credit loss, with interest revenue calculated on the carrying amount [net of the allowance for credit loss], rather than the gross carrying value of the financial assets.

The Company assesses the credit risk of the mortgages based on the expected repayments of principal and interest. All mortgages with arrears that are less than 30 days past due are included in Stage 1 whereas mortgages with principal in arrears between 31 to 90 days are included in Stage 2. Mortgages in these two stages are not considered to be impaired, and the Company recognizes a 12-month ECL for Stage 1 mortgages and a lifetime ECL for Stage 2 mortgages. When a mortgage is in arrears for over 90 days or the Company has issued a legal demand for repayment, there is an expectation of a detrimental impact on the estimated cash flows and, therefore, the Company considers the mortgages as impaired and includes in Stage 3.

The Company's ECL impairment model is built on an unbiased and probability-weighted method, determined by evaluating a range of possible outcomes supported by past loss events and expectation of future possible outcomes, discounted to reflect the time value of money. The key inputs in the measurement of ECL include Probability of Default, Loss Given Default and forecast of future economic conditions which involves significant judgment.

Hedge accounting

On January 1, 2018, the Company adopted hedge accounting within IFRS 9 for certain mortgage commitments and funded mortgages. Hedge accounting has been applied prospectively from that date. The Company did not apply hedge accounting prior to January 1, 2018.

The Company uses a combination of short Government of Canada bonds and bond repo arrangements to manage exposure to interest rate risk associate with mortgage commitments and funded mortgages held prior to securitization. In addition, the Company uses interest rate swaps to manage exposure to interest rate risk for mortgages in SPEs. The Company documents a hedging relationship between the hedging instrument and the hedged item at inception when the relationship is established. The Company also assesses the effectiveness of the hedges at both the hedge inception and on an ongoing basis. Any ineffectiveness of any hedging relationship is recognized immediately in the consolidated statements of income.

Cash flow hedges

The Company applies cash flow hedge accounting for the anticipated funding of its multi-unit residential commercial segment mortgages. At the time of mortgage commitment, the Company shorts Government of Canada bonds as the hedging instrument to hedge the cash flows on the anticipated future debt to be arranged through securitization of these mortgages obtained through CMB, disclosed as debt related to securitized mortgages. The Company also uses the same hedging strategy when placing mortgages with institutional investors who plan to use CMB funding. The effective portion of the change in the fair value of the designated hedging instrument qualifying as a cash flow hedge is recognized in other comprehensive income ["OCI"] in the consolidated statements of comprehensive income. When the hedge relationship is terminated, the cumulative amounts recognized in OCI are amortized into interest expense – securitized mortgages over the term of the securitized debt, or amortized against placement fees from institutional investors. Any change in fair value of the hedge determined as ineffective is recognized immediately in regular income.

Fair value hedges

The Company enters into interest rate swaps to protect against changes in the fair value of fixed rate mortgages funded by Asset-backed Commercial Paper ["ABCP"] debt. The Company also shorts Government of Canada bonds to manage interest rate exposure for a portion of single-family mortgage commitments and funded residential mortgages accumulated for securitization. The Company applies hedge accounting for the swaps. For the short bond hedges, the Company documents a hedging relationship during the period when the mortgages are funded until the date they are securitized or placed with an arm's length investor. The Company does not apply hedge accounting to the short bonds used to mitigate interest risk on single-family mortgage commitments. The Company's policy is not to utilize derivative financial instruments for trading or speculative purposes.

In the case of the swaps and short bonds used to hedge funded mortgages, changes in fair value of the hedged item, to the extent that the hedging relationship is effective, are offset by changes in the fair value of the hedging instrument, both of which are recognized in regular income. At hedge unwind, the realized change in the value of the hedging instrument is adjusted to the carrying value of the hedged mortgages, and amortized into interest revenue over the term of the hedged mortgages. Any changes in the fair value of an ineffective hedge will be immediately recorded in regular income.

Revenue recognition

The Company earns revenue from placement, securitization and servicing activities related to its mortgage business. The majority of originated mortgages are sold to institutional investors through the placement of mortgages or funded through securitization conduits. The Company retains servicing rights on substantially all of the mortgages it originates, providing the Company with servicing fees.

Interest revenue and expense from mortgages pledged under securitization

The Company enters into securitization transactions to fund a portion the mortgages it originated. Upon transfer of these mortgages to securitization vehicles, the Company receives cash proceeds from the transaction. These proceeds are accounted for as debt related to securitized mortgages and the Company continues to hold the mortgages on its consolidated statements of financial position, unless:

[i] substantially all of the risks and rewards associated with the financial instruments have been transferred, in which case the assets are derecognized in full; or

[ii] a significant portion, but not all, of the risks and rewards have been transferred. The asset is derecognized entirely if the transferee has the ability to sell the financial asset; otherwise the asset continues to be recognized to the extent of the Company's continuing involvement.

Where [i] or [ii] above applies to a fully proportionate share of all or specifically identified cash flows, the relevant accounting treatment is applied to that proportion of the mortgage.

For securitized mortgages that do not meet the criteria for derecognition, no gain or loss is recognized at the time of the transaction. Instead, net interest income is recognized over the term of the mortgages. Interest revenue – securitized mortgages represents interest portion of mortgage payments received and accrued by borrowers and is net of the amortization of capitalized origination costs. Interest expense – securitized mortgages represents the costs to finance these mortgages, net of the amortization of debt discounts and premiums.

Capitalized origination fees and debt discounts or premiums are amortized on an effective yield basis over the term of the related mortgages or debt.

Derecognition

A financial asset is derecognized when:

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

Placement fees and deferred placement fees receivable

The Company enters into placement agreements with institutional investors to purchase the mortgages it originates. When mortgages are placed with institutional investors, the Company transfers the contractual right to receive mortgage cash flows to the investors. Because it has transferred substantially all the risks and rewards of these mortgages, it derecognizes these assets. The Company retains a residual interest representing the rights and obligations associated with servicing the mortgages. Placement fees are earned by the Company for its origination and underwriting activities on a completed transaction basis when the mortgage is funded. Amounts immediately collected or collectible in excess of the mortgage principal are recognized as placement fees. When placement fees and associated servicing fees are earned over the term of the related mortgages, the Company determines the present value of the future stream of placement fees and records a gain on deferred placement fees and a deferred placement fees receivable. Since quoted prices are generally not available for retained interests, the Company estimates values based on the net present value of future expected cash flows, calculated using management’s best estimates of key assumptions related to expected prepayment rates and discount rates commensurate with the risks involved.

Mortgage servicing income

The Company services substantially all of the mortgages that it originates whether the mortgage is placed with an institutional investor or transferred to a securitization vehicle. In addition, mortgages are serviced on behalf of third-party institutional investors and securitization structures. For all mortgages administered for investors or third parties, the Company recognizes servicing income when services are rendered. For mortgages placed under deferred placement arrangements, the Company retains the rights and obligations to service the mortgages. The deferred placement fees receivable is the present value of the excess retained cash flows over market servicing fee rates and is reported as deferred placement revenue at the time of placement. Servicing income related to mortgages placed with institutional investors is recognized in income over the life of the servicing obligation as payments are received from mortgagors. Interest income earned by the Company from holding cash in trust related to servicing activities is classified as mortgage servicing income. The amortization of any servicing liabilities is also recorded as mortgage servicing income.

The Company provides underwriting and fulfillment processing services for mortgages originated by a large Canadian bank through its mortgage broker distribution channel. The Company recognizes servicing income when the services are rendered and the underwritten mortgages have been funded.

Mortgage investment income

The Company earns interest income from its interest-bearing assets including deferred placement fees receivable, mortgage and loan investments and mortgages accumulated for sale or securitization. Mortgage investment income is recognized on an accrual basis.

Brokerage fees

Brokerage fees are primarily fees paid to external mortgage brokers. Brokerage fees relating to mortgages placed with institutional investors are expensed as incurred, and those relating to mortgages recorded at amortized cost are capitalized to the carrying cost of the related mortgages and amortized over the term of the mortgages.

Mortgages pledged under securitization

Mortgages pledged under securitization are mortgages that the Company has originated and funded with debt raised through the securitization markets, and have been classified at amortized cost. The Company has a continuous involvement in these mortgages, including the right to receive future cash flows arising from these mortgages. Origination costs, such as brokerage fees and bulk insurance premiums that are directly attributable to the acquisition of such assets, are deferred and amortized over the term of the mortgages on an effective yield basis.

Debt related to securitized and participation mortgages

Debt related to securitized mortgages represents obligations related to the financing of mortgages pledged under securitization. This debt is measured at its amortized cost using the effective yield method. Any discount/premium and issuance costs on raising these debts that is directly attributable to obtaining such liabilities is deferred and amortized over the term of the debt obligations.

Debt related to participation mortgages represents obligations related to the financing of a portion of commercial mortgages included in mortgage and loan investments. These mortgages are subject to participation agreements with other financial institutions such that the Company's investment is subordinate to the other institutions' investment. The Company has retained various rights and a proportionately larger share of the interest earned on these mortgages, such that the full mortgage has been recorded on the Company's consolidated statements of financial position with an offsetting debt. This debt is recorded at face value and measured at its amortized cost.

Mortgages accumulated for sale or securitization

Mortgages accumulated for sale are mortgages funded for the purpose of placing with investors and are classified as FVTPL and are recorded at fair value. These mortgages are held for terms usually not exceeding 90 days.

Mortgages accumulated for securitization are mortgages funded pending arrangement of term debt through the Company's various securitization programs and are measured at amortized cost.

Securities sold short and securities purchased under resale agreements

Securities sold short consist typically of the short sale of government of Canada bonds. Bonds purchased under resale agreements consist of the purchase of a bond with the commitment from the Company to resell the bond to the original seller at a specified price. The Company uses the combination of bonds sold short and bonds purchased under resale agreements to economically hedge its mortgage commitments and the portion of funded mortgages that it intends to securitize in subsequent periods.

Bonds sold short are classified as FVTPL and are recorded at fair value. The effective yield payable on bonds sold short is recorded as hedge expense in other operating expenses. Bonds purchased under resale agreements are carried at cost plus accrued interest, which approximates their market value. The difference between the cost of the purchase and the predetermined proceeds to be received on a resale agreement is recorded over the term of the hedged mortgages as an offset to hedge expense. Transactions are recorded on a settlement date basis.

Mortgage and loan investments

Mortgage and loan investments are non-derivative financial assets with fixed or determinable payments, and are classified as FVTPL. The mortgages are measured at management's best estimate of the net realizable value. Changes in fair value are recognized immediately in the consolidated statement of income.

Property, plant and equipment

Property, plant and equipment are recorded at cost, less accumulated amortization, at the following annual rates and bases:

Computer equipment	30% declining balance
Office equipment	20% declining balance
Leasehold improvements	straight-line over the term of the lease
Computer software	30% declining balance except for a computer license, which is straight-line over 10 years

Property, plant and equipment are subject to an impairment review if there are events or changes in circumstances that indicate the carrying amount may not be recoverable.

Goodwill

Goodwill represents the price paid for the Corporation's business in excess of the fair value of the net tangible assets and identifiable intangible assets acquired in connection with the IPO. Goodwill is reviewed annually for impairment or more frequently when an event or change in circumstances indicates that the asset might be impaired.

Restricted cash

Restricted cash represents principal and interest collected on mortgages pledged under securitization that is held in trust until the repayment of debt related to these mortgages is made in a subsequent period.

Bank indebtedness

Bank indebtedness consists of bank indebtedness net of cash balances or deposit with banks.

Cash held as collateral for securitization

Cash held as collateral for securitization represents cash-based credit enhancements held by various securitization vehicles, including FNFC Trust and a Canadian Trust Company acting as the title custodian for the Company's NHA-MBS program.

Servicing liability

The Company places mortgages with third-party institutional clients, and retains the rights and obligations to service these mortgages. When the service related fees are paid upfront by a third party, the Company records a servicing liability. The liability represents the portion of the upfront fee required to earn a market rate of servicing over the related mortgage term. This is similar to the method which the Company uses to calculate deferred placement fees. Since quoted prices are generally not available for retained interests, the Company estimates its value based on the net present value of future expected cash flows, calculated using management's best estimates of key assumptions related to expected prepayment rates and discount rates commensurate with the risks involved. The Company earns the related servicing fees over the term of the mortgages on an effective yield basis.

Income taxes

The Company accounts for income taxes in accordance with the liability method of tax allocation. Under this method, the provision for income taxes is calculated based on income tax laws and income tax rates substantively enacted as at the dates of the consolidated statements of financial position. The income tax provision consists of current income taxes and deferred income taxes. Current and deferred taxes relating to items in the Company's equity are recorded directly against equity.

Current income taxes are amounts expected to be payable or recoverable as the result of operations in the current year and any adjustment to tax payable or tax recoverable amounts recorded in previous years.

Deferred income taxes arise on temporary differences between the carrying amounts of assets and liabilities on the consolidated statements of financial position and their tax bases. Deferred tax liabilities are generally recognized for all taxable temporary differences and deferred tax assets are recognized to the extent that future realization of the tax benefit is probable. Deferred taxes are calculated using the tax rates expected to apply in the periods in which the assets will be realized or the liabilities settled. Deferred tax assets and liabilities are offset when they arise in the same tax reporting group and relate to income taxes levied by the same taxation authority, and when a legal right to offset exists in the entity.

Earnings per common share

The Company presents earnings per share ["EPS"] amounts for its common shares. EPS is calculated by dividing the net earnings attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the year.

3. Mortgages pledged under securitization

The Company securitizes residential and commercial mortgages in order to raise debt to fund these mortgages. Most of these securitizations consist of the transfer of fixed and floating rate mortgages into securitization programs, such as ABCP, NHA-MBS, and the Canada Mortgage Bonds [“CMB”] program. In these securitizations, the Company transfers the assets to structured entities for cash, and incurs interest-bearing obligations typically matched to the term of the mortgages. These securitizations do not qualify for derecognition, although the structured entities and other securitization vehicles have no recourse to the Company’s other assets for failure of the mortgages to make payments when due.

As part of the ABCP transactions, the Company provides cash collateral for credit enhancement purposes as required by the rating agencies. Credit exposure to securitized mortgages is generally limited to this cash collateral. The principal and interest payments on the securitized mortgages are paid by the Company to the structured entities monthly over the term of the mortgages. The full amount of the cash collateral is recorded as an asset and the Company anticipates full recovery of these amounts. NHA-MBS securitizations may also require cash collateral in some circumstances. As at December 31, 2018, the cash held as collateral for securitization was $75,913 [2017 – $66,413].

The following table compares the carrying amount of mortgages pledged for securitization and the associated debt:

	2018	
	Carrying amount of securitized mortgages	**Carrying amount of associated liabilities**
	$	$
Securitized mortgages	**30,385,005**	**30,876,519**
Capitalized hedge loss	**12,578**	**––**
Capitalized origination costs	**169,453**	**––**
Debt discounts	**––**	**(113,868)**
	30,567,036	**30,762,651**
Add		
Principal portion of payments held in restricted cash	**521,690**	**––**
	31,088,726	**30,762,651**

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	2017	
	Carrying amount of securitized mortgages	**Carrying amount of associated liabilities**
	$	$
Securitized mortgages	27,427,239	27,914,097
Mark-to-market adjustment	(1,683)	—
Capitalized origination costs	141,121	—
Debt discounts	—	(80,340)
	27,566,677	27,833,757
Add		
Principal portion of payments held in restricted cash	514,793	—
Participation debt	—	323
	28,081,470	27,834,080

The principal portion of payments held in restricted cash represents payments on account of mortgages pledged under securitization which has been received at year end but has not yet been applied to reduce the associated debt. This cash is applied to pay down the debt in the month subsequent to collection. In order to compare the components of mortgages pledged under securitization to securitization debt, this amount is added to the carrying value of mortgages pledged under securitization in the above table.

Mortgages pledged under securitization have been classified as amortized cost and are carried at par plus adjustment for unamortized origination costs.

The changes in capitalized origination costs for the years ended December 31 are summarized as follows:

	2018	**2017**
	$	$
Opening balance, January 1	**141,121**	138,940
Add: new origination costs capitalized in the year	**103,222**	70,716
Less: amortization in the year	**(74,890)**	(68,535)
Ending balance, December 31	**169,453**	141,121

During the year ended December 31, 2018, the Company invested in mortgages that were transferred into the securitization vehicles with principal balances as of December 31, 2018 of $7,418,415 [2017 – $5,928,283].

The contractual maturity profile of the mortgages pledged under securitization programs is summarized as follows:

	$
2019	4,233,634
2020	3,794,321
2021	5,356,973
2022	6,624,587
2023 and thereafter	10,375,490
	30,385,005

The following table summarizes the mortgages pledged under securitization that are 31 days or more past due as at December 31:

	2018	**2017**
	$	$
Arrears days		
31 to 60	**48,902**	35,652
61 to 90	**4,814**	5,841
Greater than 90	**16,380**	28,707
	70,096	70,200

All the mortgages listed above are insured, except for two mortgages which are uninsured and have a total principal balance of $605 as at December 31, 2018 [2017 – $289]. The Company's exposure to credit loss is limited to uninsured mortgages with principal balances totaling $1,251,236 [2017 – $1,106,796], before consideration of the value of underlying collateral. Virtually all such mortgages are conventional prime single-family mortgages, with an 80% or less loan to value ratio at origination, and verified borrower income. Accordingly, the expected credit loss related to these mortgages is insignificant, and the Company has not provided any allowance for ECL for the year ended December 31, 2018.

4. Deferred placement fees receivable

The Company enters into transactions with institutional investors to sell primarily fixed-rate mortgages in which placement fees are received over time as well as at the time of the mortgage placement. These mortgages are derecognized when substantially all of the risks and rewards of ownership are transferred and the Company has minimal exposure to the variability of future cash flows from these mortgages. The investors have no recourse to the Company's other assets for failure of mortgagors to make payments when due.

Deferred placement fees receivable is classified as amortized cost, and has been calculated initially based on the present value of the anticipated future stream of placement fees. An assumption of no credit losses was used, commensurate with the credit quality of the investors. An assumption of no prepayment for the commercial segment was used, as borrowers cannot refinance for financial advantage without paying the Company a fee commensurate with the value of its investment in the mortgage. The effect of variations, if any, between actual experience and assumptions will be recorded in future statements of income but is expected to be minimal.

During the year ended December 31, 2018, $2,655,764 [2017 – $2,005,667] of mortgages were placed with institutional investors, which created gains on deferred placement fees of $11,747 [2017 – $10,020]. Cash receipts on deferred placement fees receivable for the year ended December 31, 2018 were $12,979 [2017 – $12,772].

The Company estimates that the expected undiscounted cash flows to be received on the deferred placement fees receivable will be as follows:

	$
2019	11,893
2020	9,638
2021	7,700
2022	5,752
2023 and thereafter	12,519
	47,502

5. Mortgages accumulated for sale or securitization

Mortgages accumulated for sale or securitization consist of mortgages the Company has originated for its own securitization programs, together with mortgages funded in advance of settlement with institutional investors.

Mortgages originated for the Company's own securitization programs are classified as amortized cost and are recorded at par plus adjustment for unamortized origination costs. Mortgages funded for placement with institutional investors are designated as FVTPL and are recorded at fair value. The fair values of mortgages classified as FVTPL approximate their carrying values as the time period between origination and sale is short. The following table summarizes the components of mortgages according to their classification:

	2018	**2017**
	$	$
Mortgages accumulated for securitization	**2,170,416**	1,770,275
Mortgages accumulated for sale	**34,470**	19,490
	2,204,886	1,789,765

The Company's exposure to credit loss is limited to $321,341 [2017 – $569,571] of principal balances of uninsured mortgages within mortgages accumulated for securitization, before consideration of the value of underlying collateral. As at December 31, 2018, none of these mortgages are in arrears past 31 days. These are conventional prime single-family mortgages similar to the mortgages described in note 3. Accordingly the expected credit loss related to these mortgages is insignificant.

6. Mortgage and loan investments

Mortgage and loan investments consist primarily of commercial first and second mortgages held for various terms, the majority of which mature within twelve months.

Mortgage and loan investments are measured at FVTPL, and are recorded on a fair value basis. Any changes in fair value are immediately recognized in income. The Company recorded a fair value loss of $4,000 for the year ended December 31, 2018. The mortgages were classified as loans and receivables prior to the adoption of IFRS 9, and a $4,000 credit loss related to these mortgages was recorded as an offset to mortgage investment income on the consolidated statement of income for the year ended December 31, 2017.

The following table discloses the composition of the Company's portfolio of mortgage and loan investments by geographic region as at December 31, 2018:

Province/Territory	**Portfolio balance**	**Percentage of portfolio**
	$	%
Alberta	**5,678**	3.01
British Columbia	**17,855**	9.46
Manitoba	**21,162**	11.22
New Brunswick	**2,678**	1.42
Newfoundland and Labrador	**56**	0.03
Nova Scotia	**4,046**	2.15
Nunavut	**134**	0.07
Ontario	**108,654**	57.58
Quebec	**27,993**	14.84
Saskatchewan	**122**	0.07
Yukon	**288**	0.15
	188,666	100.00

The following table discloses the mortgages that are past due as at December 31:

	2018	**2017**
	$	$
Arrears days		
31 to 60	**4,871**	13,433
Greater than 90	**39,232**	43,974
	44,103	57,407

The portfolio contains $13,133 [December 31, 2017 – $15,145] of insured mortgages and $175,533 [December 31, 2017 – $364,568] of uninsured mortgage and loan investments as at December 31, 2018. Of the uninsured mortgages, approximately $39,941 [December 31, 2017 – $49,693] have principal balances in arrears of more than 30 days. Three of these mortgages are non-performing and the Company has stopped accruing interest. These mortgages had a total original principal balance of $44,001 and are recorded at a fair value of $25,262 as at December 31, 2018 [December 31, 2017 – four mortgages, original principal balance of $48,600, and fair value of $32,001].

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The maturity profile in the table below is based on the earlier of contractual renewal or maturity dates.

	2019	2020	2021	2022	2023 and thereafter	2018 Book value	2017 Book value
	$	$	$	$	$	$	$
Residential	**11,647**	**924**	**8,254**	**5,261**	**10,441**	**36,527**	34,820
Commercial	**113,366**	**33,173**	**1,800**	**2,057**	**1,743**	**152,139**	344,893
	125,013	**34,097**	**10,054**	**7,318**	**12,184**	**188,666**	379,713

Interest income earned for the year was $17,654 [2017 – $18,610] and is included in mortgage investment income on the consolidated statements of income.

7. Other assets

The components of other assets are as follows as at December 31:

	2018	2017
	$	$
Property, plant and equipment, net	**9,371**	11,670
Goodwill	**29,776**	29,776
	39,147	41,446

The recoverable amount of the company's goodwill is calculated by reference to the Company's market capitalization, mortgages under administration, origination volume, and profitability. These factors indicate that the Corporation's recoverable amount exceeds the carrying value of its net assets and accordingly, goodwill is not impaired.

8. Mortgages under administration

As at December 31, 2018, the Company managed mortgages under administration of $106,151,363 [2017 – $101,589,153], including mortgages held on the Company's consolidated statements of financial position. Mortgages under administration are serviced for financial institutions such as banks, insurance companies, pension funds, mutual funds, trust companies, credit unions and securitization vehicles. As at December 31, 2018, the Company administered 306,221 mortgages [2017 – 301,492] for 111 institutional investors [2017 – 103] with an average remaining term to maturity of 40 months [2017 – 41 months].

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Mortgages under administration are serviced as follows:

	2018 $	2017 $
Institutional investors	**59,768,374**	59,601,263
Mortgages accumulated for sale or securitization and mortgage and loan investments	**2,387,285**	2,190,393
Deferred placement investors	**12,441,436**	11,125,228
Mortgages pledged under securitization	**30,385,005**	27,427,239
CMBS conduits	**1,169,263**	1,245,030
	106,151,363	101,589,153

The Company's exposure to credit loss is limited to mortgage and loan investments as described in note 6, securitized mortgages as described in note 3 and uninsured mortgages held in mortgages accumulated for securitization as described in note 5. As at December 31, 2018, the Company has included in accounts receivable and sundry $86 [2017 – $86] of uninsured non-performing mortgages.

The Company maintains trust accounts on behalf of the investors it represents. The Company also holds municipal tax funds in escrow for mortgagors. Since the Company does not hold a beneficial interest in these funds, they are not presented on the consolidated statements of financial position. The aggregate of these accounts as at December 31, 2018 was $630,166 [2017 – $670,259].

9. Bank indebtedness

Bank indebtedness includes a revolving credit facility of $1,250,000 [2017 – $1,060,000] maturing in March 2023. At December 31, 2018, $918,347 [2017 – $643,828] was drawn, of which the following have been pledged as collateral:

[a] a general security agreement over all assets, other than real property, of the Company; and

[b] a general assignment of all mortgages owned by the Company.

The credit facility bears a variable rate of interest based on prime and bankers' acceptance rates.

10. Debt related to securitized and participation mortgages

Debt related to securitized mortgages represents the funding for mortgages pledged under the NHA-MBS, CMB and ABCP programs. As at December 31, 2018, debt related to securitized mortgages was $30,762,651 [2017 – $27,833,757], net of unamortized discounts of $113,868 [2017 – $80,340]. A comparison of the carrying amounts of the pledged mortgages and the related debt is summarized in note 3.

As at December 31, 2018, the Company did not record any debt related to participation mortgages [December 31, 2017 – $323].

Debt related to securitized and participation mortgages is reduced on a monthly basis when the principal payments received from the mortgages are applied. Debt discounts and premiums are amortized over the term of each debt on an effective yield basis. Debt related to securitization mortgages had a similar contractual maturity profile as the associated mortgages in mortgages pledged under securitization.

11. Swap contracts

Swaps are over-the-counter contracts in which two counterparties exchange a series of cash flows based on agreed upon rates to a notional amount. The Company uses interest rate swaps to manage interest rate exposure relating to variability of interest earned on mortgages pledged under securitization. The swap agreements that the Company enters into are interest rate swaps where two counterparties exchange a series of payments based on different interest rates applied to a notional amount in a single currency.

The following tables present, by remaining term to maturity, the notional amounts and fair values of the swap contracts outstanding as at December 31, 2018 and 2017:

	2018				
	Less than 3 years	**3 to 5 years**	**6 to 10 years**	**Total notional amount**	**Fair value**
	$	$	$	$	$
Interest rate swap contracts	**2,011,026**	**1,634,911**	**20,671**	**3,666,608**	**40,549**

	2017				
	Less than 3 years	**3 to 5 years**	**6 to 10 years**	**Total notional amount**	**Fair value**
	$	$	$	$	$
Interest rate swap contracts	1,138,520	3,139,547	10,370	4,288,437	57,565

Positive fair values of the interest rate swap contracts are included in accounts receivable and sundry and negative fair values are included in accounts payable and accrued liabilities on the consolidated statements of financial position.

12. Senior unsecured notes

On April 9, 2015, the Company issued $175 million of new senior unsecured notes for a five-year term maturing on April 9, 2020. The notes bear interest at 4.01% payable in equal semi-annual payments commencing October 9, 2015. The net proceeds of the issuance [$174.3 million, net of financing fees] have been invested in FNFLP.

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13. Commitments, guarantees and contingencies

As at December 31, 2018, the Company has the following operating lease commitments for its office premises:

	$
2019	7,467
2020	7,418
2021	7,238
2022 and thereafter	13,966
	36,089

Outstanding commitments for future advances on mortgages with terms of one to 10 years amounted to $1,192,677 as at December 31, 2018 [2017 – $1,634,058]. The commitments generally remain open for a period of up to 90 days. These commitments have credit and interest rate risk profiles similar to those mortgages that are currently under administration. Certain of these commitments have been sold to institutional investors while others will expire before being drawn down. Accordingly, these amounts do not necessarily represent future cash requirements of the Company.

In the normal course of business, the Company enters into a variety of guarantees. Guarantees include contracts where the Company may be required to make payments to a third party, based on changes in the value of an asset or liability that the third party holds. In addition, contracts under which the Company may be required to make payments if a third party fails to perform under the terms of the contract [such as mortgage servicing contracts] are considered guarantees. The Company has determined that the estimated potential loss from these guarantees is insignificant.

14. Securities transactions under repurchase and resale agreements

The Company's outstanding securities purchased under resale agreements and securities sold under repurchase agreements have a remaining term to maturity of less than three months.

15. Obligations related to securities and mortgages sold under repurchase agreements

The Company uses repurchase agreements to fund specific mortgages included in mortgages accumulated for sale or securitization. The current contracts are with financial institutions, are based on bankers' acceptance rates and mature on or before January 31, 2019.

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16. Accounts payable and accrued liabilities

The major components of accounts payable and accrued liabilities are as follows as at December 31:

	2018 $	2017 $
Accrued liabilities	**15,303**	39,195
Accrued dividends payable	**10,249**	9,946
Accrued interest on securitization debt	**57,777**	43,940
Servicing liability	**17,981**	18,876
Swap liabilities	**23,141**	6,124
	124,451	118,081

Accrued interest on securitization debt is the interest due on securitization related debt due subsequent to year end.

17. Shareholders' equity

[a] Authorized

Unlimited number of common shares
Unlimited number of cumulative 5-year rate reset preferred shares, Class A Series 1
Unlimited number of cumulative 5-year rate reset preferred shares, Class A Series 2

[b] Capital stock

	Common shares		Preferred shares	
	#	$	#	$
Balance, December 31, 2018 and 2017	**59,967,429**	**122,671**	**4,000,000**	**97,394**

[c] Preferred shares

On January 25, 2011, the Company issued 4 million Class A Series 1 Preferred Shares at a price of $25.00 per share for gross proceeds of $100,000 before issue expenses.

Holders of Class A Series 1 Preferred Shares have the right, at their option, to convert their shares into cumulative, floating rate Class A Preferred Shares, Series 2 ["Series 2 Preferred Shares"], subject to certain conditions, on March 31, 2021 and on March 31 every five years thereafter. As of December 31, 2018, there were 2,887,147 Series 1 preferred shares and 1,112,853 Series 2 preferred shares outstanding with a total carrying value of $97,394.

Holders of the Class A Series 1 Preferred Shares receive a cumulative quarterly fixed dividend at a rate equal to the five-year Government of Canada yield plus 2.07%. The dividend rate may be reset every five years, as and when approved by the Board of Directors. The current dividend rate on the Class A Series 1 shares is 2.79% annually for a new five year term ending March 31, 2021.

Holders of the Series 2 Preferred Shares will be entitled to receive cumulative quarterly floating dividends at a rate equal to the three-month Government of Canada Treasury bill yield plus 2.07%, as and when declared by the Board of Directors.

Both classes of Preferred Shares do not have voting rights, are redeemable only at the option of the Company, and are therefore classified as equity. The par value per preferred share is $25.

[d] Earnings per share

	2018 $	**2017** $
Net income attributable to shareholders	**166,427**	208,078
Less: dividends declared on preferred shares	**(2,928)**	(2,747)
Net earnings attributable to common shareholders	**163,499**	205,331
Number of common shares outstanding	**59,967,429**	59,967,429
Basic earnings per common share	**2.73**	3.42

18. Income taxes

The major components of deferred tax expense for the years ended December 31 consist of the following:

	2018 $	**2017** $
Related to origination and reversal of temporary differences	**4,857**	11,650
Increase in future tax rates	**333**	—
	5,190	11,650

The major components of current income tax expense for the years ended December 31 consists of the following:

	2018 $	**2017** $
Income taxes relating to the current year	**56,100**	64,100
Income taxes related to the prior year	**(300)**	—
	55,800	64,100

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The effective income tax rate reported in the consolidated statements of comprehensive income varies from the Canadian tax rate of 26.64% for the year ended December 31, 2018 [2017 – 26.52%] for the following reasons:

	2018	**2017**
	$	$
Company's statutory tax rate	**26.64%**	26.52%
Income before income taxes	**227,417**	285,402
Income tax at statutory tax rate	**60,584**	75,689
Increase (decrease) resulting from		
Income not subject to tax	**––**	(111)
Permanent differences	**316**	291
Changes in future tax rates	**333**	(39)
Tax recovery from prior years	**(300)**	—
Other	**57**	(80)
Income tax expense	**60,990**	75,750

The movement in significant components of the Company's deferred tax liabilities and assets for the years ended December 31, 2018 and 2017 are as follows:

	As at January 1, 2018	**Recognized in income and OCI**	**As at December 31, 2018**
	$	$	$
Deferred income tax (assets) liabilities			
Deferred placement fees receivable	**10,946**	**132**	**11,078**
Capitalized broker fees	**37,610**	**7,411**	**45,021**
Unamortized discount on debt related to securitized mortgages	**21,306**	**9,043**	**30,349**
Unrealized gains on interest rate swaps	**17,866**	**(11,981)**	**5,885**
Other	**77**	**(13)**	**64**
Carrying values of mortgages pledged under securitization in excess of tax values	**(446)**	**22**	**(424)**
Cumulative eligible capital property	**(4,561)**	**300**	**(4,261)**
Servicing liability	**(5,006)**	**216**	**(4,790)**
Fair value adjustments not deducted for tax purposes	**(3,042)**	**(1,080)**	**(4,122)**
Total	**74,750**	**4,050**	**78,800**

The amount recognized in income and OCI consists of income tax expense of $5,190 recorded in income and a recovery of $1,140 record in OCI related to unrealized losses on cash flow hedges.

	As at January 1, 2017	Recognized in income	As at December 31, 2017
	$	$	$
Deferred income tax (assets) liabilities			
Deferred placement fees receivable	11,660	(714)	10,946
Capitalized broker fees	38,015	(405)	37,610
Carrying values of mortgages pledged under securitization in excess of tax values	5,671	(6,117)	(446)
Unamortized discount on debt related to securitized mortgages	15,331	5,975	21,306
Unrealized gains on interest rate swaps	4,787	13,079	17,866
Other	589	(512)	77
Cumulative eligible capital property	(4,908)	347	(4,561)
Servicing liability	(4,749)	(257)	(5,006)
Loan loss reserves not deducted for tax purposes	(3,296)	254	(3,042)
Total	63,100	11,650	74,750

The calculation of taxable income of the Company is based on estimates and the interpretation of tax legislation. In the event that the tax authorities take a different view from management, the Company may be required to change its provision for income taxes or deferred tax balances and the change could be significant.

19. Financial instruments and risk management

Risk management

The various risks to which the Company is exposed and the Company's policies and processes to measure and manage them individually are set out below:

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. The Company's exposure to the risk of changes in market interest rates relates primarily to the Company's mortgages accumulated for securitization.

The Company uses various strategies to reduce interest rate risk. The Company's risk management objective is to maintain interest rate spreads from the point that a mortgage commitment is issued to the transfer of the mortgage to the related securitization vehicle or sale to an institutional investor. Primary among these strategies is the Company's decision to sell mortgages at the time of commitment, passing on interest rate risk that exists prior to funding to institutional investors. The Company uses synthetic bond forwards [consisting of bonds sold short and bonds purchased under resale agreements] to manage interest rate exposure between the time a mortgage rate is committed to the borrower and the time the mortgage is sold to a securitization vehicle and the underlying cost of funding is set. As interest rates change, the values of these interest rate dependent financial instruments vary inversely with the values of the mortgage contracts. As interest rates increase, a gain will be recorded on the economic hedge which will be offset by the reduced future spread on mortgages pledged under securitization as the mortgage rate committed to the borrower is fixed at the point of commitment.

For single-family mortgages, only a portion of the commitments issued by the Company eventually fund. The Company must assign a probability of funding to each mortgage in the pipeline and estimate how that probability changes as mortgages move through the various stages of the pipeline. The amount that is actually economically hedged is the expected value of the mortgages funding within the future commitment period.

The table below provides the financial impact that an immediate and sustained 100 basis point and 200 basis point increase and decrease in short-term interest rates would have had on the net income of the Company in 2018 and 2017.

	Decrease in interest rate [1]		**Increase in interest rate**	
	2018	**2017**	**2018**	**2017**
	$	$	$	$
100 basis point shift				
Impact on net income and equity attributable to shareholders	**4,816**	1,946	**(4,816)**	(958)
200 basis point shift				
Impact on net income and equity attributable to shareholders	**9,632**	10,875	**(9,632)**	(1,917)

[1] Interest rate is not decreased below 0%.

Credit risk

Credit risk is the risk of loss associated with a counterparty's inability or unwillingness to fulfill its payment obligations. The Company's credit risk is mainly lending related in the form of mortgage default. The Company uses stringent underwriting criteria and experienced adjudicators to mitigate this risk. The Company's approach to managing credit risk is based on the consistent application of a detailed set of credit policies and prudent arrears management. As at December 31, 2018, 96% [2017 – 96%] of the pledged mortgages were insured mortgages. See details in note 3. The Company's exposure is further mitigated by the relatively short period over which a mortgage is held by the Company prior to securitization.

The maximum credit exposures of the financial assets are their carrying values as reflected on the consolidated statements of financial position. The Company does not have significant concentration of credit risk within any particular geographic region or group of customers.

The Company is at risk that the underlying mortgages default and the servicing cash flows cease. The large portfolio of individual mortgages that underlies these assets is diverse in terms of geographical location, borrower exposure and the underlying type of real estate. This diversity and the priority ranking of the Company's rights mitigate the potential size of any single credit loss.

Securities purchased under resale agreements are transacted with large regulated Canadian institutions such that the risk of credit loss is very remote. Securities transacted are all Government of Canada bonds and, as such, have virtually no risk of credit loss.

Liquidity risk and capital resources

Liquidity risk is the risk that the Company will be unable to meet its financial obligations as they come due.

The Company's liquidity strategy has been to use bank credit to fund working capital requirements and to use cash flow from operations to fund longer-term assets. The Company's credit facilities are typically drawn to fund: [i] mortgages accumulated for sale or securitization, [ii] origination costs associated with mortgages pledged under securitization, [iii] cash held as collateral for securitization, [iv] costs associated with deferred placement fees receivable and [v] mortgage and loan investments. The Company has a credit facility with a syndicate of eleven financial institutions, which provides for a total of $1,250,000 in financing.

The Company finances the majority of its mortgages with debt derived from the securitization markets, primarily NHA-MBS, ABCP and CMB. Debt related to NHA-MBS and ABCP securitizations reset monthly such that the receipts of principal on the mortgages are used to pay down the related debt within a 30-day period. Accordingly, these sources of financing amortize at the same rate as the mortgages pledged thereunder, providing an almost perfectly matched asset and liability relationship.

Market risk

Market risk is the risk of loss that may arise from changes in market factors such as interest rates and credit spreads. The level of market risk to which the Company is exposed varies depending on market conditions, expectations of future interest rates and credit spreads.

Customer concentration risk

Placement fees and mortgage servicing income from one Canadian financial institution represent approximately 9.0% [2017 – 9.9%] of the Company's total revenue.

Fair value measurement

The Company uses the following hierarchy for determining and disclosing the fair value of financial instruments recorded at fair value in the consolidated statements of financial position:

Level 1 – quoted market price observed in active markets for identical instruments;
Level 2 – quoted market price observed in active markets for similar instruments or other valuation techniques for which all significant inputs are based on observable market data; and
Level 3 – valuation techniques in which one or more significant inputs are unobservable.

Valuation methods and assumptions

The Company uses valuation techniques to estimate fair values, including reference to third-party valuation service providers using proprietary pricing models and internal valuation models such as discounted cash flow analysis. The valuation methods and key assumptions used in determining fair values for the financial assets and financial liabilities are as follows:

[a] Mortgages and loan investments

Mortgages and loan investments are measured at FVTPL. The fair value of these mortgages is based on non-observable inputs, and is measured at management's best estimated of the net realizable value.

[b] Deferred placement fees receivable

The fair value of deferred placement fees receivable is determined by internal valuation models using market data inputs, where possible. The fair value is determined by discounting the expected future cash flows related to the placed mortgages at market interest rates. The expected future cash flows are estimated based on certain assumptions which are not supported by observable market data.

[c] Securities owned and sold short

The fair values of securities owned and sold short used by the Company to hedge its interest rate exposure are determined by quoted prices on a secondary market.

[d] Servicing liability

The fair value of the servicing liability is determined by internal valuation models using market data inputs, where possible. The fair value is determined by discounting the expected future cost related to the servicing of explicit mortgages at market interest rates. The expected future cash flows are estimated based on certain assumptions which are not supported by observable market data.

[e] Other financial assets and financial liabilities

The fair value of mortgages accumulated for sale or securitization, cash held as collateral for securitization, restricted cash and bank indebtedness correspond to the respective outstanding amounts due to their short-term maturity profiles.

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[f] Fair value of financial instruments not carried at fair value

The fair value of these financial instruments are determined by discounting projected cash flows using market industry pricing practices, including the rate of unscheduled prepayment. Discount rates used are determined by comparison to similar term loans made to borrowers with similar credit. This methodology will reflect changes in interest rates which have occurred since the mortgages were originated. These fair values are estimated using valuation techniques in which one or more significant inputs are unobservable [Level 3], and are calculated for disclosure purposes only.

Carrying value and fair value of selected financial instruments

The fair value of the financial assets and financial liabilities of the Company approximates its carrying value, except for mortgages pledged under securitization, which has a carrying value of $30,567,036 [2017 – $27,566,677] and a fair value of $31,071,851[2017 – $27,557,542], debt related to securitized and participation mortgages, which has a carrying value of $30,762,651 [2017 – $27,834,080], and a fair value of $30,574,471 [2017 – $27,748,498], and senior unsecured notes, which have a carrying value of $174,829 [December 31, 2017 – $174,693], and a fair value of $175,856 [December 31, 2017 – $176,372].

The following tables represent the Company's financial instruments measured at fair value on a recurring basis as at December 31:

	2018			
	Level 1	**Level 2**	**Level 3**	**Total**
	$	$	$	$
Financial assets				
Mortgages accumulated for sale	**—**	**34,470**	**—**	**34,470**
Mortgage and loan investments	**—**	**—**	**188,666**	**188,666**
Interest rate swaps	**––**	**51,410**	**––**	**51,410**
Total financial assets	**––**	**85,880**	**188,666**	**274,546**
Financial liabilities				
Securities sold short	**––**	**2,183,411**	**––**	**2,183,411**
Interest rate swaps	**––**	**4,784**	**––**	**4,784**
Total financial liabilities	**––**	**2,188,195**	**––**	**2,188,195**

	2017			
	Level 1	**Level 2**	**Level 3**	**Total**
	$	$	$	$
Financial assets				
Mortgages accumulated for sale	—	19,490	—	19,490
FVTPL mortgages	—	—	2,986,097	2,986,097
Deferred placement fees receivable	—	—	41,273	41,273
Interest rate swaps	—	63,689	—	63,689
Total financial assets	—	83,179	3,027,370	3,110,549

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	2017			
	Level 1	**Level 2**	**Level 3**	**Total**
	$	$	$	$
Financial liabilities				
Securities sold short	—	2,180,253	—	2,180,253
Interest rate swaps	—	6,124	—	6,124
Total financial liabilities	—	2,186,377	—	2,186,377

In estimating the fair value of financial assets and financial liabilities using valuation techniques or pricing models, certain assumptions are used, including those that are not fully supported by observable market prices or rates [Level 3]. The amount of the change in fair value recognized by the Company in net income for the year ended December 31, 2018 that was estimated using a valuation technique based on assumptions that are not fully supported by observable market prices or rates was approximately a loss of $4,000 [2017 – $26,342]. Although the Company's management believes that the estimated fair values are appropriate as at the date of the consolidated statements of financial position, those fair values may differ if other reasonably possible alternative assumptions are used.

Transfers between levels in the fair value hierarchy are deemed to have occurred at the beginning of the period in which the transfer occurred. Transfers between levels can occur as a result of additional or new information regarding valuation inputs and changes in their observability. During 2018 and 2017, the Company did not have any transfers between levels.

The following table presents changes in the fair values, including realized gains of $32,942 [2017 – $33,006] of the Company's financial assets and financial liabilities for the years ended December 31, 2018 and 2017, all of which have been classified as FVTPL:

	2018	**2017**
	$	$
FVTPL mortgages	**(4,000)**	(25,312)
Deferred placement fees receivable	**––**	(1,030)
Securities sold short	**6,189**	35,468
Interest rate swaps	**1,340**	47,133
	3,529	56,259

The above table includes an unrealized fair value loss of $4,000 on the mortgage and loan investments. These mortgages were classified as loan and receivables under IAS 39 prior to January 1, 2018, but have now been classified as FVTPL under IFRS 9. Accordingly, there is no gain or loss reported in 2017 with respect to mortgage and loan investments. The mortgages pledged under securitization that were classified as FVTPL in 2017 have now been classified as amortized cost with the transition to IFRS 9. Accordingly, there is no gain or loss reported in 2018 with respect to mortgages pledged under securitization.

The Company does not have any assets or liabilities that are measured at fair value on a non-recurring basis.

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Movement in Level 3 financial instruments measured at fair value

The following tables show the movement in Level 3 financial instruments in the fair value hierarchy for the years ended December 31, 2018 and 2017. The Company classifies financial instruments to Level 3 when there is reliance on at least one significant unobservable input in the valuation models.

	Fair value as at December 31, 2017 under IAS 39	Fair value as at January 1, 2018 under IFRS 9	Investments	Unrealized losses recorded in income	Payment and amortization	Fair value as at December 31, 2018
	$	$	$	$	$	$
Financial assets						
FVTPL mortgages	**2,986,097**	**—**	**—**	**—**	**—**	**—**
Deferred placement fees receivable	**41,273**	**—**	**—**	**—**	**—**	**—**
Mortgage and loan investments	**––**	**379,713**	**44,294**	**(4,000)**	**(231,341)**	**188,666**
	3,027,370	**379,713**	**44,294**	**(4,000)**	**(231,341)**	**188,666**

	Fair value as at January 1, 2017	Investments	Unrealized losses recorded in income	Payment and amortization	Fair value as at December 31, 2017
	$	$	$	$	$
Financial assets					
FVTPL mortgages	2,663,756	1,612,325	(25,312)	(1,264,672)	2,986,097
Deferred placement fees receivable	43,933	9,452	(1,030)	(11,082)	41,273
Mortgage and loan investments	41,858	10,049	—	(51,907)	—
	2,749,547	1,631,826	(26,342)	(1,327,661)	3,027,370

20. Capital management

The Company's objective is to maintain a capital base so as to maintain investor, creditor and market confidence and sustain future development of the business. Management defines capital as the Company's common share capital and retained earnings. FNFLP has a minimum capital requirement as stipulated by its bank credit facility. The agreement limits the debt under bank indebtedness together with the unsecured notes to four times FNFLP's equity. As at December 31, 2018, the ratio was 1.90:1 [2017 – 1.39:1]. The Company was in compliance with the bank covenant throughout the year.

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21. Earnings by business segment

The Company operates principally in two business segments, Residential and Commercial. These segments are organized by mortgage type and contain revenue and expenses related to origination, underwriting, securitization and servicing activities. Identifiable assets are those used in the operations of the segments.

	2018		
	Residential	**Commercial**	**Total**
	$	$	$
Revenue			
Interest revenue – securitized mortgages	**607,672**	**182,520**	**790,192**
Interest expense – securitized mortgages	**(495,386)**	**(150,683)**	**(646,069)**
Net interest – securitized mortgages	**112,286**	**31,837**	**144,123**
Placement and servicing	**236,636**	**63,195**	**299,831**
Mortgage investment income	**61,821**	**26,504**	**88,325**
Realized and unrealized gains on financial instruments	**7,171**	**(4,009)**	**3,162**
	417,914	**117,527**	**535,441**
Expenses			
Amortization	**3,943**	**988**	**4,931**
Interest	**54,659**	**15,290**	**69,949**
Other operating	**194,414**	**38,730**	**233,144**
	253,016	**55,008**	**308,024**
Income before income taxes	**164,898**	**62,519**	**227,417**
Identifiable assets	**27,719,231**	**8,288,120**	**36,007,351**
Goodwill	**—**	**—**	**29,776**
Total assets	**27,719,231**	**8,288,120**	**36,037,127**
Capital expenditures	**1,842**	**790**	**2,632**

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	2017		
	Residential	**Commercial**	**Total**
	$	$	$
Revenue			
Interest revenue – securitized mortgages	500,789	157,994	658,783
Interest expense – securitized mortgages	(382,604)	(129,335)	(511,939)
Net interest – securitized mortgages	118,185	28,659	146,844
Placement and servicing	237,041	58,409	295,450
Mortgage investment income	47,452	20,824	68,276
Realized and unrealized gains on financial instruments	41,878	14,381	56,259
	444,556	122,273	566,829
Expenses			
Amortization	4,074	1,061	5,135
Interest	37,635	8,793	46,428
Other operating	187,477	42,387	229,864
	229,186	52,241	281,427
Income before income taxes	215,370	70,032	285,402
Identifiable assets	25,653,160	7,093,342	32,746,502
Goodwill	—	—	29,776
Total assets	25,653,160	7,093,342	32,776,278
Capital expenditures	2,974	1,275	4,249

22. Related party and other transactions

The Company has servicing contracts in connection with several originated commercial mezzanine mortgages subsequently sold to various entities controlled by a senior executive and shareholder of the Company. The Company services these mortgages during their terms at market commercial servicing rates. During the year, the Company originated $128,465 of new mortgages for the related parties. The related parties also funded several mortgage related progress draws totalling $9,149 on existing mortgages originated by the Company. All such mortgages, which are administered by the Company, have a balance of $121,556 as at December 31, 2018 [December 31, 2017 – $61,034]. As at December 31, 2018, three of the mortgages are secured by real estate in which the Company is also a subordinate mortgage lender.

A senior executive and shareholder of the Company has a significant investment in a mortgage default insurance company. In the ordinary course of business, the insurance company provides insurance policies to the Company's borrowers at market rates. In addition, the insurance company has also provided the Company with portfolio insurance at market premiums. The total bulk insurance premium paid in 2018 was $2,339 [2017 – $494], net of third-party investor reimbursement. The insurance company has also engaged the Company to service a portfolio of mortgages at market commercial servicing rates. As at December 31, 2018, the portfolio had a balance of $1,625 [2017 – $3,822].

23. Future accounting changes

The following accounting pronouncement issued by the IASB, although not yet effective, may have a future impact on the Company:

IFRS 16 – *Leases*

In January 2016, the IASB issued IFRS 16 – *Leases*, replacing IAS 17 – *Leases*. IFRS 16 requires lessees to recognize assets and liabilities for most leases instead of previous categories of finance leases, which are reported on the balance sheet, or operating leases, which are disclosed only in the notes to the financial statements, under IAS 17. IFRS 16 also set out enhanced guidance for the recognition, measurement, presentation and disclosure of the leasing activities. IFRS 16 is effective for annual periods beginning on or after January 1, 2019.

The Company's major leases are office space leases for its Toronto head office and four regional offices. The Company's various office equipment leases are insignificant for application of the new standard. Based on the preliminary assessment, the Company will apply IFRS 16 on a modified retrospective approach, and record approximately $30 million as right-of-use asset as well as lease liability on its consolidated statements of financial position as of January 1, 2019.