FIRST NATIONAL

FINANCIAL CORPORATION

Delivering Service. ***Creating Solutions.*** ***Building Success.***

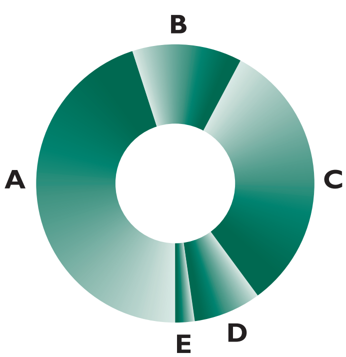
2011 ANNUAL REPORT

Corporate Profile

First National Financial Corporation (TSX: FN) wholly owns First National Financial LP, a Canadian-based originator, underwriter and servicer of predominantly prime residential (single-family and multi-unit) and commercial mortgages. With almost $60 billion in mortgages under administration, First National is Canada's largest non-bank originator and underwriter of mortgages, and ranks among the top three in market share in the growing mortgage broker distribution channel.

2011 Performance at a Glance

FUNDING SOURCES
(for the year ended December 31, 2011)



A **45%** Institutional placements

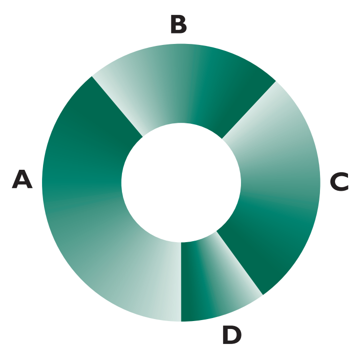
B **13%** CMB dealers

C **32%** NHA–MBS

D **8%** ABCP

E **2%** Internal company resources

REVENUE SOURCES PRIOR TO FAIR VALUE LOSSES
(for the year ended December 31, 2011)



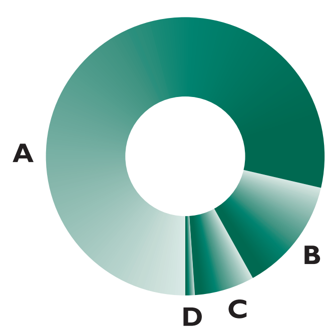
A **39%** Institutional placements

B **23%** Net interest – securitized mortgages

C **28%** Mortgage servicing

D **10%** Investment income

MORTGAGES UNDER ADMINISTRATION
(for the year ended December 31, 2011)



A **79%** Insured

B **13%** Multi-unit and commercial

C **7%** Conventional single-family residential

D **1%** Bridge loans/Alt-A

92% **Insured or conventional single-family residential**

Investment Highlights

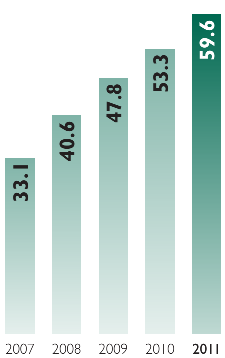
> Canada's largest non-bank mortgage originator

> Leader in high-growth mortgage broker distribution channel

> High-quality mortgage portfolio

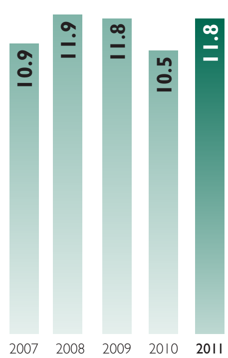
> Diverse revenue and funding sources

MORTGAGES UNDER ADMINISTRATION
(in $ billions)



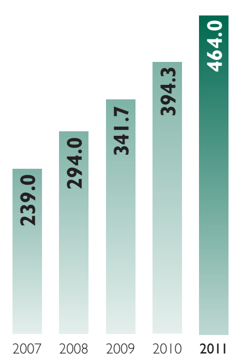
12%
Year-over-year growth 2010 to 2011

MORTGAGE ORIGINATIONS
(in $ billions)



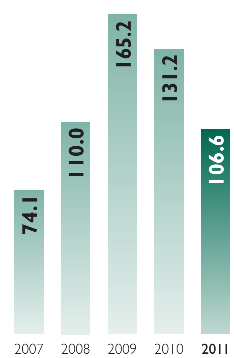
12%
Year-over-year growth 2010 to 2011

REVENUE
(in $ millions)



18%
Year-over-year growth 2010 to 2011

EBITDA
(in $ millions)



19%
Year-over-year decline 2010 to 2011

Note:
2007–2009 under Canadian GAAP;
2010–2011 under IFRS

Message from the President

Fellow Shareholders

For First National Financial Corporation, 2011 was a year characterized by solid financial and operational performance across all of our divisional segments. The Company continued to increase its value with strategic investments in future growth throughout the year. In 2011, we fully leveraged our distribution channels as our volume of originations and mortgages under administration hit record levels. The Company also transitioned to International Financial Reporting Standards (IFRS).

Throughout the year, the Canadian real estate market remained strong and First National was able to capitalize on these robust conditions to originate and service near-record levels of new mortgages in our residential, multi-unit and commercial segments. With a greater capital base resulting from our preferred share issue early in the year, we took advantage of these increased origination levels by securitizing more than $4 billion in mortgages, which will continue to benefit the Company for the five- and 10-year terms of these transactions.

The Company's improved financial performance in 2011 was due to our consistent growth-oriented strategy, a high-performing team and commitment to operational excellence.

Since First National was formed in 1988, the Company has earned a reputation as a high-quality service provider and market leader in the residential and commercial mortgage lending sectors. For more than 23 years, we have met the mortgage needs of a growing number of Canadian property owners by building strong relationships within the commercial real estate and residential broker communities. These strategic relationships allow us to build our customer base, drive our growth and profitability and further strengthen our leadership position in this increasingly competitive marketplace.

Record Financial Performance

In 2011, First National achieved strong financial and operational results in the following key performance metrics:

- Mortgages under administration increased 12% year-over-year to $59.6 billion;
- Revenue grew to $464.0 million from $394.3 million in 2010, reflecting the increased interest revenue on securitized mortgages;
- Income before income taxes decreased 19% to $96.8 million from $120.0 million in 2010;

- EBITDA decreased to $106.6 million in 2011 from $131.2 million compared to the previous year; and
- The Company paid out dividends at $1.25 per share during the year, which represents an increase of 16% over the tax-effected regular distribution of the Corporation's predecessor (First National Financial Income Fund) in 2010. Together with payments on account of income tax, the Company paid out $108.0 million in 2011, or $18.1 million more than in 2010, on a tax-equivalent basis.

We are very pleased with origination volumes and mortgages under administration levels reached in 2011, and anticipate overall volumes to remain at comparable levels in 2012 and beyond.

With a solid capital base and a strong balance sheet, First National is well positioned to grow our market share and increase profitability, allowing us to deliver solid and reliable returns to our shareholders. We will continue to enhance our operations, products and services while leveraging our

The First National Management Team

Left to right: Susan Biggar, General Counsel; Jason Ellis, Managing Director, Capital Markets; Jeremy Wedgbury, Managing Director, Commercial Mortgage Origination; Stephen Smith, Chairman and President; Moray Tawse, Vice President, Mortgage Investments; Robert Inglis, Chief Financial Officer; Lisa White, Vice President, Mortgage Administration; Scott McKenzie, Vice President, Residential Mortgages

leadership position within the mortgage broker distribution channel to better meet the needs of all of our stakeholders.

A Passion for Growth

First National's success has been building for 23 years, and our focus is still on growth. The Company was founded in 1988 by Moray Tawse and myself when the securitization market was just developing. At that time, the mortgage broker channel accounted for just 3% of the market. Today, brokers account for approximately 30% of the mortgage financing in Canada.

From the very beginning, we placed a high priority on service and a commitment to assist brokers in efficiently meeting the needs of clients. This was coupled with our strongly held belief that investing in leading-edge technology would enable us to deliver on this commitment. These two objectives were realized together through the development of MERLIN, a proprietary mortgage approval and tracking system.

With the growth of Canada's real estate markets and the accompanying need for mortgages, First National expanded its operations to meet the growing demand. The Company opened an office in Vancouver in 1991, and subsequent offices in Calgary and Montreal, to establish a presence in Canada's key regional markets. With our conservative, disciplined approach to underwriting, our record of superior service and administrative capabilities, large institutions started looking to us to originate mortgage product.

Looking back over the history of our Company, a great deal of our success can be attributed to the experience and effectiveness of the management team. Each member is committed to contributing to First National's strong business performance and future growth. Over the past several years, our team has played a key role in propelling us forward to realize our vision and consolidate our position as the leading non-bank mortgage lender in the industry.

We are most fortunate to have a dedicated group of employees who believe in this Company and who are committed to building on its success and growing in the future. A number of our staff members have been part of the First National family since we started this business more than 20 years ago, and both Moray and I take great pride in that they have remained with us.

Industry Developments

As a result of the market turmoil in 2011, the large Canadian banks increased mortgage spreads in order to raise profitability on these assets. This was most evident in the fourth quarter, as floating-rate single-family mortgages that had been priced at a 0.70% discount to the prime rate in the summer were offered at no discount to prime. Similarly, fixed-rate mortgages were priced so as to increase spreads to a range of 1.75% to 2.00%. These increases enabled First National's securitization activities to be more profitable.

First National's consistent year-over-year growth has consolidated our position as the market leader in non-bank mortgage lending.

In addition, Canada's large banks also made the transition to IFRS this year. Together with increased capital requirements from Basel 3, there will be little incentive for the banks to decrease spreads. First National has seen competitors exit the market or slow down origination in the face of higher capital requirements for securitization, a direct consequence of these changes.

Outlook

As we proceed through 2012, the Company forecasts that mortgages under administration will continue to grow and produce higher income and cash flow. The wider mortgage spreads on our core products – prime mortgages – will give First National the opportunity to continue to securitize directly, retaining a large part of the economics of origination.

With our large investment in the portfolio of mortgages under securitization and servicing portfolio at the end of this past year, First National expects increased cash flow and profitability going forward.

Looking Ahead

First National will continue to operate according to our four key strategies for ongoing success, including:

- Providing a full range of mortgage solutions;
- Growing assets under administration;
- Employing leading-edge technology to lower costs and rationalize business processes; and
- Maintaining a conservative risk profile.

These proven strategies will continue to deliver strong results and business growth, allowing First National to further extend our solid record of returns to our shareholders as the Company builds on its strengths and consolidates its position as a leading mortgage lender.

I am proud of the financial and operational achievements we recorded in 2011, and look forward to the further growth of our business in 2012 and beyond. I'd like to thank our Board members for their guidance throughout the year, our shareholders for their continued support, the management team and our employees once again for their hard work and contributions, as well as our customers for their loyalty and support. Going forward, First National will continue to grow our established brand and outperform the market by doing what we do best – delivering service, creating solutions and building success.

Sincerely,

Stephen Smith

Stephen Smith
Chairman and President

Our philosophy is unique in its simplicity: we deliver service, create solutions and build success.

Through a combination of our innovative mortgage solutions, MERLIN – our industry-leading mortgage approval and tracking system – and our team of experts, First National has earned the trust of mortgage brokers, commercial clients as well as residential customers.

These strong relationships are thanks to our unwavering commitment to delivering excellent service – a commitment shared by senior management and every member of the First National team.

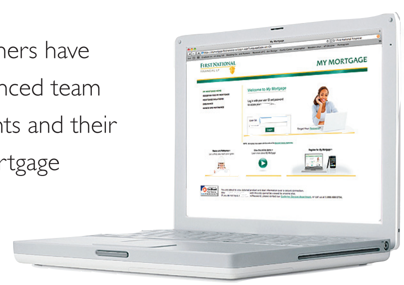
Delivering Service.

We are committed to providing industry-leading service across all areas of our business. First National offers fast turnaround times for mortgage applications. Commercial clients often receive their mortgage commitment documents in as little as seven days, while mortgage brokers often receive responses to their submissions within four hours. In independent surveys, First National is continually ranked #1 by mortgage brokers for exceptional service.

"First National has a very flexible approach. They look at each deal with a 'can-do' attitude and creative thinking."

– A.K., Senior Vice President, Finance

Additionally, homeowners have access to our experienced team of customer care agents and their own personalized mortgage management tool, *My Mortgage,* online or by phone.



"My needs have been met with awesome, courteous, and seamless service. I received the best customer service that I have had for as long as I can remember."

– K.P., Dartmouth, NS

Creating Solutions.

At First National, we put all of our resources and expertise behind the development, administration and servicing of mortgage solutions.

Each commercial mortgage inquiry starts with a professional mortgage consultation and analysis. A First National commercial mortgage expert will analyze the client's needs and develop a customized proposal detailing the loan strategy, preferred terms, best rate solution and optimum financing recommendation.

"First National's product line-up provides us with flexible financing solutions that allow us to focus on the enhancement of our properties."

– B.D., President and CEO

Residential mortgage brokers have access to a wide range of mortgage solutions, flexible payment terms and prepayment privileges to suit just about any lifestyle.

MERLIN, First National's exclusive industry-leading online mortgage approval and tracking system, ensures mortgage brokers stay connected to the status of their deal, so they can exceed customers' expectations and maximize their operational efficiencies.

MERLIN

"First National continues to be the industry standard with their customer-driven technology – MERLIN."

– J.S., Winnipeg, MB

Building Success.

For many Canadians, buying their first home is a dream. Whether our homebuyers are new to Canada, self-employed or making their first purchase, together with their mortgage broker, we are all committed to helping them make this dream come true as easily and worry-free as possible.

"I appreciate speaking with a real person. I also find your staff courteous and helpful. You took the time to explain my options, allowing me to choose the best plan."

– S.B., Ottawa, ON

Time and time again, mortgage brokers tell us that a key component of excellent service is fast turnaround times so that they can differentiate themselves from the competition. First National responds to 90% of mortgage broker submissions in less than four hours.

"Anyone looking to become a leader in the broker industry should consider First National as their lender of choice."

– D.I., Toronto, ON

Financial Reporting

Table of Contents

Management's Discussion and Analysis

Financial Statements

Management's Discussion and Analysis

The following management's discussion and analysis of financial condition and results of operations is prepared as of February 28, 2012. This discussion should be read in conjunction with the audited consolidated financial statements of First National Financial Corporation (the "Company" or "Corporation" or "First National") as at and for the year ended December 31, 2011 and the notes thereto. This discussion should also be read in conjunction with the audited consolidated financial statements and notes thereto of the Company's predecessor, First National Financial Income Fund, and First National Financial LP ("FNFLP") for the year ended December 31, 2010. The audited consolidated financial statements of the Company have been prepared in accordance with International Financial Reporting Standards ("IFRS").

This MD&A contains forward-looking information. Please see "Forward-Looking Information" for a discussion of the risks, uncertainties and assumptions relating to these statements. The selected financial information and discussion below also refer to certain measures to assist in assessing financial performance. These other measures such as "EBITDA", "Adjusted Cash Flow", and "Adjusted Cash Flow per Unit" should not be construed as alternatives to net income or loss or other comparable measures determined in accordance with IFRS as an indicator of performance or as a measure of liquidity and cash flow. These measures do not have standard meanings prescribed by IFRS and therefore may not be comparable to similar measures presented by other issuers.

Unless otherwise noted, tabular amounts are in thousands of Canadian dollars.

Additional information relating to the Corporation and FNFLP is available in the Corporation's profile on the System for Electronic Data Analysis and Retrieval ("SEDAR") website at www.sedar.com.

General Description of the Company

First National Financial Corporation is the parent company of First National Financial LP, a Canadian-based originator, underwriter and servicer of predominantly prime residential (single family and multi-unit) and commercial mortgages. With over $59 billion in mortgages under administration ("MUA"), First National is Canada's largest non-bank originator and underwriter of mortgages and is among the top three in market share in the growing mortgage broker distribution channel. Pursuant to a Plan of Arrangement (the "Arrangement") and an amalgamation (the "Amalgamation") effective January 1, 2011, First National Financial Corporation succeeded First National Financial Income Fund (the "Fund") as the public holding company invested in FNFLP. The Arrangement and Amalgamation (together, the "Conversion") were used to convert the Fund into a corporate structure. The most significant steps involved in the Conversion were:

- A new company, First National Financial Inc. ("FNFI") was formed;
- Unitholders of the Fund exchanged their 12,681,113 units in the Fund for shares in FNFI on a one-for-one basis;
- The pre-Arrangement shareholders of the Corporation (the "Co-founders") exchanged 47,286,316 shares in the Corporation for 47,286,316 shares of FNFI with the result that the Corporation became a wholly-owned subsidiary of FNFI;
- The Fund and First National Financial Operating Trust were wound up; and
- The Corporation and FNFI were amalgamated and continued under the name "First National Financial Corporation".

Basis of Presentation

The financial statements of the Corporation are prepared in accordance with IFRS. Effectively, the Conversion reorganized the ownership interests in FNFLP such that all such interests are now consolidated and held through the Corporation in the same ratio as previously held by the Fund and by the Co-founders. Prior to the initial public offering of the Fund (the "IPO") in June 2006, the Corporation owned and operated the business of First National. Concurrent with the IPO, the business of First National was transferred from the Corporation to FNFLP such that the Corporation then operated as a privately held holding company which owned a direct interest of 80.03% in FNFLP. At that time, the Fund indirectly held a 19.97% non-controlling interest in FNFLP. Given that the Conversion does not involve any arm's-length transactions at fair market value, the Corporation has accounted for these transactions under the concept of a pooling of interests under common control. Accordingly, the Corporation's financial statements reflect the combined activities of the Fund and the Corporation prior to the Arrangement (including the consolidation of FNFLP). Immediately prior to the Arrangement, residual assets and liabilities of the Corporation were distributed and settled so that as of the Arrangement date, the consolidated balance sheet of the Corporation substantially reflects the assets and liabilities of FNFLP at carrying value, plus the intangible assets represented by the excess of the purchase price paid by the Fund over the carrying value of its share of the net assets of FNFLP at the IPO date and the deferred tax liabilities related to temporary differences between the book and tax basis of the carrying value of the Fund's investment in FNFLP. In effect this accounting treatment assumes, for comparative financial reporting purposes, that the Conversion occurred at the time of the IPO. As all significant revenue earned by the Corporation in 2010 came from its investment in FNFLP, the effect on the comparative earnings is minimal; however, to the extent the Corporation earned revenue and incurred expenses, these are recorded in the 2010 comparative figures. The Co-founders have provided indemnities to the Corporation to protect the current shareholders of the Corporation from any unrecorded liabilities incurred and unpaid by the Corporation in the period between the IPO and January 1, 2011. Accordingly, the prior year's comparative figures have been restated to account for both the Conversion and IFRS.

Restatement of Comparative Figures

Conversion to a corporation

Prior to the Conversion, the Fund was the public entity with an investment in FNFLP, the operating entity. It accounted for its investment in FNFLP using the equity method, effectively consolidating the results of FNFLP in one line of equity pick up. Because of the limited usefulness of this financial reporting, the Company made public the results of FNFLP on a stand-alone basis every reporting period. Now that FNFLP is wholly-owned by the publicly traded corporation, its assets, liabilities and results will be consolidated at the reporting issuer level, and presentation of separate financial information for FNFLP will no longer be necessary. In order to present appropriate comparative information, the Company will restate the 2010 results and year end balances for FNFLP and the Fund as if FNFLP had been consolidated with the Fund and the Corporation since the IPO. This restatement is summarized below. The table takes the historical balance sheet of FNFLP as at December 31, 2010 and the income statement for the year ended December 31, 2010, and adjusts for values historically accounted for at the Fund level and the financial position and results of operations of the Corporation for the same periods. In particular, these adjustments pertain to $65.0 million of intangible assets (servicing rights and broker relationships) and $29.8 million of goodwill which the Fund recorded on the IPO, and deferred tax liabilities of $57.8 million related to tax temporary differences embedded in the carrying value of the Fund's investment in FNFLP. As at December 31, 2010, the net book value of the intangible assets was $32.5 million as these assets have been amortized since the IPO.

Restatement of FNFLP's 2010 financial results pursuant to the Conversion
($000s)

	First National Financial LP as previously presented	Conversion adjustments	As restated for First National Financial Corporation pursuant to the Conversion
	December 31 2010		December 31 2010
Balance sheet			
Operating assets	$ 1,149,082	$ 1	$ 1,149,083
Intangible assets	–	32,499	32,499
Goodwill	–	29,776	29,776
Total assets	$ 1,149,082	$ 62,276	$ 1,211,358
Operating liabilities	$ 887,722	$ (38,793)	$ 848,929
Tax liabilities	–	43,661	43,661
Total liabilities	887,722	4,868	892,590
Equity	261,360	57,408	318,768
Total liabilities and equity	$ 1,149,082	$ 62,276	$ 1,211,358
	Year ended December 31 2010		Year ended December 31 2010
Income statement			
Revenue	$ 343,214	$ 102	$ 343,316
Expenses – operating	(181,787)	(1,443)	(183,230)
– amortization	–	(9,468)	(9,468)
Income before taxes	161,427	(10,809)	150,618
Provision for taxes	–	(30,040)	(30,040)
Net income for the period	$ 161,427	$ (40,849)	$ 120,578

Transition to IFRS

In January 2006, the Canadian Accounting Standards Board announced its decision requiring all publicly accountable entities to report under IFRS. This decision established standards for financial reporting with increased clarity and consistency in the global marketplace. These standards are effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011 and are applicable beginning with the Company's first quarter of 2011. For the Company, this has meant a significant change in its accounting policy regarding revenue recognition, particularly in accounting for securitization transactions. Under Canadian GAAP, the Company's securitizations were considered "true sales" for accounting purposes such that the Company recorded gains on securitization when these mortgages were sold to various securitization conduits. Under IFRS, these securitizations do not meet the definition of a "true sale" and instead are accounted for as secured financings. Accordingly, the Company's securitizations (through ABCP conduits, National Housing Act – Mortgage Backed Securities ("NHA–MBS") and direct Canada Mortgage Bonds ("CMB") issuance) do not qualify for sale accounting. Its deferred placement transactions will continue to meet the criteria for off-balance sheet treatment as the risks and rewards associated with the ownership of these mortgages have been transferred to an arm's-length institution.

The Company has restated its comparative 2010 financial statements as if IFRS accounting standards had been applied retroactively. This restatement eliminates all securitization receivables as at December 31, 2009, and puts these mortgages back on the Company's balance sheet together with securitization debt related to these transactions. The restated balance sheet under IFRS as at December 31, 2010 has a number of significant changes. As well as the reversal of the securitization receivables, the balance sheet also features: 1) An increase in the amount of the Company's mortgage assets by approximately $7.2 billion; 2) An increase of $0.2 billion in restricted cash representing principal received on these mortgages in December 2010 and held in trust until the subsequent month; 3) An increase of the Company's liabilities by an amount of $7.3 billion for notes payable associated with the securitized assets; 4) A decrease in deferred tax liabilities of $23.1 million, as the net tax-related temporary difference associated with securitization receivables has been reduced; and 5) A decrease in opening equity of $61.6 million, primarily reflecting the after-tax effect of reversing previously recognized securitization gains. The increase in mortgage assets also includes the addition of approximately $47 million of unamortized deferred origination costs, primarily broker fees, which had been expensed under Canadian GAAP. The deferred origination costs will be amortized against interest revenue on the securitized mortgage portfolio over the term of the mortgages on an effective yield basis.

The Company has also disclosed a restated statement of income under IFRS for the third quarter of 2010. Generally this quarter featured large volumes of securitized mortgages and, accordingly, under Canadian GAAP large gains on securitization were recorded. These revenues are reversed under IFRS and are replaced with the net interest margin from previously recorded securitization transactions.

In July 2010, the IFRS Interpretations Committee issued a staff paper which described their discussion of certain transition issues for "derecognition" accounting under IFRS. In particular, the extent of retroactive application of these standards for new adopters was debated. Currently the standard requires retroactive treatment for application of this accounting change, but only for transactions occurring after January 1, 2004. The Committee recommended that instead of this fixed date, the date should be defined as the date of transition to IFRS (or January 1, 2010 for Canadian issuers). The Committee's recommendation has now been adopted into IFRS with an effective date of June 2011. The Company has chosen not to early adopt this standard and has accounted for the transition with retroactive application to January 1, 2004. The Company believes that to adopt this new standard would result in inconsistent financial information being presented, particularly on the balance sheet.

The table below restates the 2010 results, as restated above for the Conversion, under IFRS.

Restatement of FNFC's 2010 financial results pursuant to IFRS
($000s)

	As restated for First National Financial Corporation pursuant to the Conversion	IFRS adjustments	As restated for First National Financial Corporation pursuant to IFRS
	December 31 2010		December 31 2010
Balance sheet			
Mortgages pledged under securitization	$ –	$ 7,193,961	$ 7,193,961
Securitization receivable	157,443	(157,443)	–
Other operating assets	991,640	156,117	1,147,757
Intangible assets	32,499	–	32,499
Goodwill	29,776	–	29,776
Total assets	$ 1,211,358	$ 7,192,635	$ 8,403,993
Debt related to securitized mortgages	$ –	$ 7,274,482	$ 7,274,482
Operating liabilities	848,929	2,745	851,674
Tax liabilities	43,661	–	43,661
Total liabilities	892,590	7,277,227	8,169,817
Equity	318,768	(84,592)	234,176
Total liabilities and equity	$ 1,211,358	$ 7,192,635	$ 8,403,993
	Year ended December 31 2010		Year ended December 31 2010
Income statement			
Revenue – gain on securitization	$ 60,227	$ (60,227)	$ –
– other	283,089	111,170	394,259
Expenses – operating	(183,230)	(81,604)	(264,834)
– amortization	(9,468)	–	(9,468)
Income before taxes	150,618	(30,661)	119,957
Provision for taxes	(30,040)	–	(30,040)
Net income for the period	$ 120,578	$ (30,661)	$ 89,917

2011 Results Summary

The Company was pleased with its operational results for 2011, including its transformation from an income trust to a dividend-paying corporation and the adoption of IFRS. Although its financial results were not as strong as the comparative results from 2010, the decrease in profitability pertains primarily to adverse capital markets conditions experienced in the third and fourth quarters. In 2011 First National continued to build its portfolio of mortgages pledged under securitization, increased overall origination volumes, and grew both net interest margin and mortgage servicing revenue. Mortgages under administration continued to grow and the Company financed more mortgages directly with the CMB program.

- MUA grew to $59.6 billion at December 31, 2011 from $53.3 billion at December 31, 2010, an annualized increase of 12%; the growth from September 30, 2011, when mortgages under administration were $58.0 billion, was 2.8%, an annualized increase of 11%;
- The Canadian single-family real estate market proved resilient despite continued economic concerns and volatile capital markets. In 2011 single-family mortgage originations for the Company increased by 9% to $9.1 billion from $8.3 billion in 2010. The commercial segment recorded even greater growth as volumes increased by 23% to $2.7 billion from $2.2 billion in 2010;
- The Company securitized a significant portion of its mortgage origination in the CMB program in the year: $498 million in the 10-year program and $1.2 billion in the five-year term programs;
- Revenue for the year ended December 31, 2011 increased to $464.0 million from $394.3 million in 2010. The growth of 18% is reflective of the increased interest revenue on securitized mortgages, particularly floating rate mortgages indexed to the prime rate, which increased by 16% from an average of 2.58% in 2010 to 3.00% for 2011. Higher mortgage servicing revenue, placement fees and mortgage investment income offset the large negative charge recorded for losses on financial instruments;
- The Company's hedging program, while appropriate, accounted for $31.0 million of the net losses on financial instruments of $18.5 million. From an economic perspective, these losses are largely offset by higher values attributable to the hedged mortgages, which will be recognized in earnings over the five- and 10-year terms of the mortgages;
- Income before income taxes decreased by 19.3% from $120.0 million in 2010 to $96.8 million in 2011. This decrease is due to volatile debt markets in the year which negatively affected the Company's interest rate hedges. Despite this charge, the year produced steady and growing income from the Company's securitized mortgage and servicing portfolios;
- EBITDA decreased by 18.8% from $131.2 million in 2010 to $106.6 million in 2011 due to the same factors cited above for income before income taxes; and
- Dividends declared to common shareholders in 2011 increased 16% compared to tax-equivalent regular monthly distributions declared by the Fund in 2010.

The Company celebrated its five-year anniversary as a public entity after listing on the Toronto Stock Exchange ("TSX") on June 15, 2006. During those five and a half years to December 31, 2011, the Company paid out $459 million in distributions and dividends to unitholders and shareholders. This represents a pre-tax return of 77% on the IPO price of $10 per unit. With the appreciation of the value of the Company since the IPO, original unitholders have earned a total pre-tax return of over 150% (at the year-end share price) on the IPO investment.

Outstanding Securities of the Corporation

At December 31, 2011 and February 28, 2012, the Corporation had 59,967,429 common shares, 4,000,000 Series 1, Class A preference shares and 175,000 debentures outstanding.

Selected Quarterly Information

Quarterly results of First National Financial Corporation

($000s, except per share amounts)

	Revenue	Net income for the period	Net income per common share (unit)	Total assets
2011				
Fourth quarter	**$ 118,121**	**$ 17,687**	**$ 0.27**	**$ 11,927,270**
Third quarter	**$ 115,522**	**$ 12,107**	**$ 0.18**	**$ 10,754,813**
Second quarter	**$ 121,579**	**$ 20,197**	**$ 0.32**	**$ 9,948,118**
First quarter	**$ 108,798**	**$ 20,500**	**$ 0.33**	**$ 9,261,178**
2010 (1)				
Fourth quarter	$ 116,011	$ 25,580	$ 0.43	$ 8,404,005
Third quarter	$ 105,238	$ 22,161	$ 0.37	$ 8,330,026
Second quarter	$ 90,411	$ 19,537	$ 0.32	$ 7,975,198
First quarter	$ 82,599	$ 22,639	$ 0.38	$ 7,338,226

(1) 2010 figures have been restated to present comparative information to account for the Conversion and IFRS.

Given First National's large amount of MUA and portfolio of mortgages pledged under securitization, quarterly revenue under IFRS is driven primarily by mortgage servicing revenue growth, and changing mortgage interest rates on mortgages pledged under securitization. Servicing will change as the portfolio of mortgages grows or contracts; however, the gross interest on the mortgage portfolio is significantly linked to the prime lending rate as the Company has pledged several billion dollars of floating rate mortgages to the NHA–MBS program. Prior to IFRS, revenue was more dependent on quarterly origination volumes and one-time securitization gains. Revenue beginning in the first quarter of 2010 onwards reflects the trend of the growing MUA and prime lending rate hikes experienced throughout 2010. The prime rate averaged 2.58% in 2010 but was 3.00% for all of 2011, an increase of 16%. In the third quarter of 2011, and to a lesser extent in the fourth quarter, the Company was affected by volatile conditions in the debt markets and its revenue was reduced by $17.4 million and $8.4 million respectively, attributable to losses in the market value of financial instruments related to its interest rate hedging program. This issue also affected net income, which was decreased in aggregate for the quarters by approximately $15.9 million on an after-tax basis.

During the eight quarters described above, except for the third and fourth quarters of 2011, mortgage spreads tightened steadily as Canadian capital markets returned to historical norms following the credit turmoil of 2008. This trend is evident in net income figures except for the fourth quarter of 2010, when the Company reduced the amount of mortgages originated for its securitization program and earned increased upfront placement fee revenue, and in the third and fourth quarters of 2011, when large mark-to-market adjustments on financial instruments reduced earnings. Total assets have grown steadily as the Company has taken advantage of securitization opportunities in order to grow its mortgage assets pledged under securitization.

Selected Annual Financial Information for the Company's Fiscal Year

($000s, except per share/unit amounts)

	December 31 2011	December 31 2010 (2)	December 31 2009 (2)
For the year then ended			
Income statement highlights			
Revenue	**$ 464,020**	$ 394,259	$ 341,716
Interest expense – securitized mortgages	**(184,291)**	(112,530)	–
Brokerage fees	**(81,480)**	(70,718)	(98,677)
Other operating expenses	**(91,642)**	(81,586)	(77,807)
EBITDA (1)	**106,607**	131,221	165,232
Amortization of capital assets	**(1,856)**	(1,796)	(1,749)
Amortization of intangible assets	**(7,968)**	(9,468)	–
Provision for income taxes	**(26,292)**	(30,040)	–
Net Income	**70,491**	89,917	163,483
Dividends/distributions declared	**109,022**	89,623	86,953
Per share/unit highlights			
Net income per unit/common share	**1.10**	1.50	2.73
Dividends/distributions declared per common share/unit	**1.25**	1.49	1.45
At year end			
Balance sheet highlights			
Total assets	**11,927,270**	8,403,993	1,067,690
Total long-term financial liabilities	**$ 184,689**	$ 178,849	$ –

(1) EBITDA is not a recognized earnings measure under IFRS and does not have a standardized meaning prescribed by IFRS. Therefore, EBITDA may not be comparable to similar measures presented by other issuers. Investors are cautioned that EBITDA should not be construed as an alternative to net income or loss determined in accordance with IFRS as an indicator of the Company's performance or as an alternative to cash flows from operating, investing and financing activities as a measure of liquidity and cash flows.

(2) Information for 2010 has been restated to conform to presentation under IFRS and for the Conversion. Information for 2009 has been presented using historical figures for FNFLP under Canadian GAAP.

Vision and Strategy

The Company provides mortgage financing solutions to virtually the entire mortgage market in Canada. By offering a full range of mortgage products, with a focus on customer service and superior technology, the Company believes that it is the leading non-bank mortgage lender in the industry. Growth has been achieved while maintaining a relatively conservative risk profile. The Company intends to continue leveraging these strengths to lead the "non-bank" mortgage lending industry in Canada, while appropriately managing risk.

The Company's strategy is built on four cornerstones: providing a full range of mortgage solutions; growing assets under administration; employing leading-edge technology to lower costs and rationalize business processes; and maintaining a conservative risk profile. An important element of the Company's strategy is its direct relationship with the mortgage borrower. Although the Company places most of its originations with third parties, FNFLP is perceived by all of its borrowers as the mortgage lender. This is a critical distinction. It allows the Company to communicate with each borrower directly throughout the term of the related mortgage. Through this relationship, the Company can negotiate new transactions and pursue marketing initiatives. Management believes this strategy will provide long-term profitability and sustainable brand recognition for the Company.

Key Performance Drivers

The Company's success is driven by the following factors:

- Growth in the portfolio of mortgages under administration;
- Growth in the origination of higher margin mortgages;
- Lowering the costs of operations through the innovation of systems and technology; and
- Employing innovative securitization transactions to minimize funding costs.

Growth in Portfolio of Mortgages under Administration

Management considers the growth in MUA to be a key element of the Company's performance. The portfolio grows in two ways: through mortgages originated by the Company and through mortgage servicing portfolios purchased from third parties. Mortgage originations not only drive placement and securitization revenues, but, perhaps more importantly, longer term values such as servicing fees, mortgage administration fees, renewal opportunities and growth in customer base for marketing initiatives. As at December 31, 2011, MUA totalled $59.6 billion, up from $53.3 billion at December 31, 2010, a rate of increase of 12%. This compares to $58.0 billion at September 30, 2011, representing a quarter-over-quarter increase of 2.8% and an annualized increase of 11%.

Growth in Origination of Higher Margin Mortgages

The Company's main focus has always been on the prime single-family mortgage market. Prior to 2008, when the capital markets experienced some significant turbulence, these mortgages had tight spreads such that the Company's strategy was to sell these mortgages on commitment to institutional investors and retain the servicing. This strategy changed with the challenges in the credit environment and the Company was able to take a larger portion of the spread for itself. By the end of 2010, much of the turmoil in the capital markets had waned and mortgage spreads returned to modest premiums over pre-crisis levels. This is most evident for five-year fixed rate single-family mortgage rates compared to similar-term Government of Canada bonds. Prior to 2008, this comparison showed spreads of approximately 1.25%. With the credit crisis, these spreads reached as high as 3.00% in 2008. Between 2009 and mid 2011, spreads gradually tightened as liquidity issues at financial institutions diminished and the competition for mortgages increased such that at June 30, 2011, these mortgage spreads were at 1.46%. This changed with the United States credit rating downgrade and continuing global economic turmoil. Risk-free interest rates plummeted in the third quarter of 2011 and much like 2008, as bond yields dropped, mortgage rates remained constant such that the spread widened significantly. By the end of December 2011, the five-year spread was approximately 2.10%. In 2011, the Company has chosen to securitize a larger portion of its originations, both in the single-family and multi-family segments, to take advantage of these higher spreads. For all of 2011, the Company originated for securitization approximately $2.8 billion of single-family mortgages and $1.2 billion of fixed multi-residential mortgages in order to take advantage of these wider spreads. In the year, the Company securitized approximately $1.1 billion of floating rate single-family mortgages, $833 million of fixed single-family mortgages and over $1 billion of fixed multi-residential mortgages.

Lowering Costs of Operations

Innovation of systems and technology

The Company has always used technology to provide for efficient and effective operations. This is particularly true for its MERLIN underwriting system, Canada's only web-based real-time broker information system. By creating a paperless, 24/7-available commitment management platform for mortgage brokers, the Company is now ranked among the top three lenders by market share in the broker channel. This has translated into increased single-family origination volumes and higher closing ratios (the percentage of mortgage commitments the Company issues that actually become closed mortgages).

Preferred share issuance

On January 25, 2011, the Company issued 4,000,000 Series 1 Class A preference shares for gross proceeds of $100 million. The Company received net proceeds of $97.4 million after issuance costs net of deferred tax assets of $0.9 million. These shares are rate reset preferred shares having a stated 4.65% annual dividend rate, subject to Board of Director approval, and a par of $25 per share. The rate reset feature is at the discretion of the Company such that after the initial five-year term, the Company can choose to extend the shares for another five-year term at a fixed spread (2.07%) over the yield of the then relevant Government of Canada bond. While the investors in these shares have an option on each five-year anniversary to convert their Series 1 holdings into Series 2 preference shares (which pay floating rate dividends), there are no redemption options for these shareholders. As such, the Company considers these shares to represent a permanent source of capital and classifies the shares as equity on its balance sheet. Management believes this capital will give the Company the opportunity to pursue its strategy of increased securitization, which requires upfront investment.

Employing Innovative Securitization Transactions to Minimize Funding Costs

Approval as both an issuer of NHA–MBS and seller to the Canada Mortgage Bonds program

The Company has been involved in the issuance of NHA–MBS since 1995. This program has been very successful, with over $5 billion of NHA–MBS issued. In December 2007, the Company was approved by Canada Mortgage and Housing Corporation ("CMHC") as an issuer of NHA–MBS and as a seller into the CMB program. Issuer status has provided the Company with a funding source that it can access independently. Perhaps more importantly, seller status for the CMB gives the Company direct access to the CMB. Generally, the demand for high-quality fixed and floating rate investments increased significantly with the turmoil in 2009. This demand has continued into 2011 and allowed the Company to securitize almost $3 billion of mortgages through the NHA–MBS program during the year, including $872 million in the fourth quarter.

Canada Mortgage Bonds program

The CMB program is an initiative sponsored by CMHC whereby the Canada Housing Trust ("CHT") issues securities to investors in the form of semi-annual interest-yielding five- and 10-year bonds. The proceeds of these bonds are used to buy NHA–MBS. In previous years, the Company entered into an agreement with a Canadian bank that allowed the Company to indirectly sell a portion of the Company's residential mortgage origination into several CMB issuances. Subsequently, pursuant to the Company's approval as a seller into the CMB, the Company was able to make direct sales into the program. Because of the similarities to a traditional Government of Canada bond (both have five- and 10-year unamortizing terms and a federal government guarantee), the CMB trades in the capital markets at a modest premium to the yields on Government of Canada bonds. The ability to sell into the CMB has given the Company access to lower costs of funds on both single-family and multi-family mortgage securitizations. Because these funding structures do not amortize, the Company can fund future mortgages through this channel as the original mortgages amortize or pay out. The Company also enjoys significant demand for mortgages from investment dealers who sell directly into the CMB. Because of the effectiveness of the CMB, there have been requests from approved CMB sellers for larger issuances. CHT has indicated that it will not unduly increase the size of its issuances and has created guidelines through CMHC that limit the amount that can be sold by each seller into the CMB each quarter. The Company is also subject to these limitations.

Key Performance Indicators

The principal indicators used to measure the Company's performance are:

- Earnings before income taxes, depreciation and amortization ("EBITDA"); and
- Adjusted cash flow from operations ("Adjusted Cash Flow").

EBITDA is not a recognized measure under IFRS. However, management believes that EBITDA is a useful measure that provides investors with an indication of cash income prior to capital expenditures. EBITDA should not be construed as an alternative to net income determined in accordance with IFRS or to cash flows from operating, investing and financing activities. The Company's method of calculating EBITDA may differ from other issuers and, accordingly, EBITDA may not be comparable to measures used by other issuers.

($000s)	Quarter ended		Year ended	
	December 31 2011	December 31 2010 (2)	December 31 2011	December 31 2010 (2)
For the period				
Revenue	**$ 118,121**	$ 116,011	**$ 464,020**	$ 394,259
Income before income taxes	**24,287**	33,029	**96,783**	119,957
EBITDA (1)	**26,347**	35,938	**106,607**	131,221
At period end				
Total assets	**11,927,270**	8,403,993	**11,927,270**	8,403,993
Mortgages under administration	**59,598,596**	53,293,132	**59,598,596**	53,293,132

(1) This non-IFRS measure adjusts income before income taxes by adding back expenses for amortization of intangible and capital assets.
(2) December 2010 figures have been restated for the Conversion and transition to IFRS.

Adjusted Cash Flow is not a defined term under IFRS. Management believes that net cash generated by the Company prior to investing and financing activities is an important measure for investors to monitor. Management cautions investors that, due to the Company's nature as a mortgage seller and securitizer, there will be significant variations in this measure from quarter to quarter as the Company collects and invests cash from mortgage transactions. Adjusted Cash Flow is determined by the Company as cash provided from operating activities increased/decreased by the change in mortgages accumulated for sale or securitization in the period. Mortgages accumulated for sale or securitization consist primarily of mortgages that the Company funds ahead of securitization transactions. Normally during the month after funding, the Company aggregates all relevant mortgages "warehoused" to date and creates a pool to sell to the NHA–MBS market. As the Company typically raises term debt through the securitization markets on these mortgages in the months subsequent to the month of funding, there are large amounts of cash invested at quarter ends. The Company's credit facilities provide full financing for the majority of these mortgage loans. Accordingly, management believes the measure of Adjusted Cash Flow is only meaningful if the change in mortgages accumulated for sale between reporting periods is accounted for.

Determination of Adjusted Cash Flow and Payout Ratio

($000s)	Quarter ended		Year ended	
	December 31 2011	December 31 2010	December 31 2011	December 31 2010
For the period				
Cash provided by (used in) operating activities	**$ (124,025)**	$ 77,834	**$ (456,358)**	$ 165,323
Add (deduct):				
Cash provided (used) related to pre-amalgamation shareholders of FNFC	**–**	412	**–**	29,746
Change in mortgages accumulated for sale or securitization between periods	**129,256**	(36,293)	**532,802**	(64,723)
Adjusted cash flow (1)	**5,231**	41,953	**76,444**	130,346
Less: cash dividends on preference shares	**(1,163)**	–	**(3,154)**	–
Adjusted cash flow available for common shareholders	**$ 4,068**	$ 41,953	**$ 73,290**	$ 130,346
Adjusted cash flow per common share ($/share) (1)	**0.07**	0.70	**1.22**	2.17
Dividends/distributions declared on common shares/units	**18,740**	34,303	**74,960**	114,444
Dividends/distributions declared per common share/unit ($/share)/($/unit)	**0.31**	0.57	**1.25**	1.91
Payout ratio	**443%**	81%	**102%**	88%

(1) These non-IFRS measures adjust cash provided by (used in) operating activities by accounting for changes between periods in mortgages accumulated for sale or securitization and mortgage securitization activity.

For the year ended December 31, 2011, the payout ratio was 102%. For the year ended December 31, 2010, the payout ratio was 88%. The increase in the payout ratio is a result of the higher dividend declared in 2011 compared to the tax-adjusted distributions made in 2010. The Company paid dividends in 2011 based on an annual rate of $1.25 per share. This rate is after provision for corporate income taxes and can only be compared to the distributions of the Fund if the distributions are adjusted on the same tax basis. The $1.50 annual distribution rate of the Fund in 2010 represents approximately $1.08 on an after-tax basis. Accordingly, the current dividend rate of $1.25 per share represents an increase of 16% from the prior year. Together with payments on account of income tax, the Company distributed $108.0 million in 2011 or $18.1 million more than in 2010, on a tax equivalent basis. If the Company had chosen to distribute the same after-tax equivalent as in 2010, the payout ratio in 2011 would have been approximately 89%.

For the fourth quarter of 2011, the payout ratio was 443%. This large ratio is reflective of the large unrealized losses on account of the Company's hedging program incurred in the third quarter. Although accrued for accounting purposes in the third quarter, these losses became cash losses in the fourth quarter when the Company closed out its hedge positions. Without these items, the payout ratio for the quarter would have been 132%. The increase in the ratio from the full year's ratio of 102% is due to the Company's increased investment in its prime ABCP program in the quarter.

Note that in the year, the Company reclassified its cash flow activities related to mortgage securitization. The reclassification effectively increased cash used in investing activities by $1,752,800 for the year ended December 31, 2010. The cash provided by financing activities decreased by $1,857,460 for the year ended December 31, 2010. This effected a decrease in operating cash flows of $14,712 for the year ended December 31, 2010.

Revenues and Funding Sources

Mortgage origination

The Company derives a significant amount of its revenue from mortgage origination activities. The majority of mortgages originated are funded by either placement with institutional investors or securitization conduits, in each case with retained servicing. Depending upon market conditions, either an institutional placement or a securitization conduit may be the most cost-effective means for the Company to fund individual mortgages. In general, originations are allocated from one funding source to another, depending on market conditions and strategic considerations related to maintaining diversified funding sources. The Company retains servicing rights on virtually all of the mortgages it originates, which provides the Company with servicing fees to complement revenue earned through originations. For the year ended December 31, 2011, origination volume increased from $10.5 billion to $11.8 billion, or 12%, compared to 2010.

Securitization

The Company securitizes a portion of its origination through various vehicles, including NHA–MBS, CMB and asset-backed commercial paper. Although legally these transactions represent sales of mortgages, for accounting purposes, they do not meet the requirements for revenue recognition and instead are accounted for as secured financings. These mortgages remain as mortgage assets of the Company for the full term and are funded with securitization-related debt. Of the Company's $11.8 billion of originations for the year ended December 31, 2011, $4.0 billion was originated for securitization through the NHA–MBS or ABCP markets. Approximately $980 million of this origination is currently funded with ABCP-related debt.

Placement fees and gain on deferred placement fees

The Company recognizes revenue at the time that a mortgage is placed with an institutional investor. Cash amounts received in excess of the mortgage principal at the time of placement are recognized in revenue as "placement fees". The present value of additional amounts expected to be received over the remaining life of the mortgage sold (excluding normal market based servicing fees) is recorded as a "deferred placement fee". A deferred placement fee arises when mortgages with spreads in excess of "normalized" spreads are sold. Investors prefer paying the Company over time as they earn net interest margin on such transactions. Upon the recognition of a "deferred placement fee", the Company establishes a "deferred placement fee receivable" that is amortized as the fees are received by the Company. Of the Company's $11.8 billion of originations for the year ended December 31, 2011, $6.8 billion was placed with institutional investors and $710 million was originated for institutional investors involved in the issuance of NHA–MBS.

For all institutional placements and mortgages sold to institutional investors for the NHA–MBS market, the Company earns placement fees. Revenues based on these originations are equal to either (1) the present value of the excess spread, or (2) an origination fee based on the outstanding principal amount of the mortgage. This revenue is received in cash at the time of placement. In addition, under certain circumstances, additional revenue from institutional placements and NHA–MBS may be recognized as "Gain on deferred placement fees" as described above.

Mortgage servicing and administration

The Company services virtually all mortgages generated through its mortgage origination activities on behalf of a wide range of institutional investors. Mortgage servicing and administration is a key component of the Company's overall business strategy and a significant source of continuing income and cash flow. In addition to pure servicing revenues, fees related to mortgage administration are earned by the Company throughout the mortgage term. Another aspect of servicing is the administration of funds held in trust, including borrower's property tax escrow, reserve escrow and mortgage payments. As acknowledged in the Company's agreements, any interest earned on these funds accrues to the Company as partial compensation for administration services provided. The Company has negotiated favourable interest rates on these funds with the chartered banks that maintain the deposit accounts, which has resulted in significant interest revenue.

In addition to the interest income earned on securitized mortgages and deferred placement fees receivable, the Company also earns interest income on mortgage-related assets, including mortgages accumulated for sale or securitization, mortgage and loan investments and purchased mortgage servicing rights.

Results of Operations

The following table shows the volume of mortgages originated by First National and mortgages under administration for the periods indicated:

($ millions)	Quarter ended December 31 2011	Quarter ended December 31 2010	Year ended December 31 2011	Year ended December 31 2010
Mortgage originations by asset class				
Single-family residential	**$ 2,121**	$ 2,106	**$ 9,083**	$ 8,324
Multi-unit residential and commercial	**796**	645	**2,719**	2,187
Total	**$ 2,917**	$ 2,751	**$ 11,802**	$ 10,511
Funding of mortgage originations by source				
Institutional investors – residential	**$ 1,158**	$ 1,758	**$ 6,099**	$ 5,713
Institutional investors – multi-unit/commercial	**255**	154	**696**	531
NHA–MBS for institutional investors	**68**	351	**710**	1,081
NHA–MBS / CMB / ABCP securitization	**1,354**	442	**4,047**	3,021
Internal Company resources	**82**	46	**250**	165
Total	**$ 2,917**	$ 2,751	**$ 11,802**	$ 10,511
Mortgages under administration				
Single-family residential	**$ 42,251**	$ 36,948	**$ 42,251**	$ 36,948
Multi-unit residential and commercial	**17,348**	16,345	**17,348**	16,345
Total	**$ 59,599**	$ 53,293	**$ 59,599**	$ 53,293

Total mortgage origination volumes increased in the year by 12% as both multi-unit residential and single-family origination experienced a strong year despite some unfavourable economic indicators. Total commercial segment originations increased by 24% from 2010 as historically low interest rates spurred real estate owners to enter into purchase and refinance transactions, particularly for 10-year terms. Similar incentives affected the single-family segment where volumes increased by 9% over 2010. Single-family volumes have also increased as some smaller lenders have exited the market as tighter spreads and increased capital requirements have made the returns from investing in prime mortgages lower than in the previous three years. Origination for direct securitization in the NHA–MBS, CMB and ABCP programs increased from $3.0 billion in 2010 to about $4.0 billion in 2011. The change represents an increase in multi-family origination of approximately $678 million and an increase of approximately $348 million in single-family origination. This was the result of the Company's decision to securitize more of its own origination directly and use its capital base efficiently. For the fourth quarter of 2011 overall origination increased by 6% to $2.9 billion from $2.75 billion in 2010. This increase reflects a 1% increase in single-family origination figures between the periods and a 23% increase in the multi-unit residential and commercial segment and is consistent with the trends experienced throughout the year.

For the latter part of 2011, Canadian capital markets were volatile. Continued global economic issues and a slowing recovery have meant a movement of capital from the equity markets to bond markets, such that bond prices were bid up and yields fell. The mortgage market moved in step with these indicators. For the Company, these conditions had some significant impacts on its third quarter 2011 results. As an originator of mortgages, the uncertain economic conditions made for a low rate environment, making it marginally easier for the Company to originate mortgages. However, declining bond yields had a negative impact on the Company's hedging programs. The Company puts interest rate hedges on the fixed rate mortgages that it intends to finance through securitization. Those hedges are unwound as securitization-related debt is raised. Because bond yields decreased through the quarter, the Company realized lower interest rates on these debts compared to the related mortgage interest rates but incurred losses on the hedges. Although these hedges were effective for the Company, IFRS accounting requires such hedge losses to be recognized in the period while the additional interest rate spread earned on the better funding execution will be recognized over the five- and 10-year terms of the mortgages. As such the current year's net income has been negatively affected by such accounting.

Total revenues for the year ended December 31, 2011 increased by about 18% compared to 2010, from $394.3 million to $464.0 million. This increase resulted from the larger portfolio of mortgages pledged under securitization and higher mortgage rates thereon.

Net interest – securitized mortgages
Comparing the year ended December 31, 2011 to the year ended December 31, 2010, net interest – securitized mortgages increased 18% to $69.8 million from $59.0 million. The increase is due to a larger portfolio of securitized mortgages offset by tighter weighted-average spreads on the portfolio compared to those spreads a year ago. The portfolio of mortgages funded by securitization grew from $5.5 billion as at January 1, 2010 to $7.2 billion as at December 31, 2010 to $9.8 billion as at December 31, 2011. However, the market for prime mortgages became more competitive during this period. At December 31, 2010, the Company's securitized mortgage portfolio earned gross spreads of approximately 1.37%. By December 31, 2011, as higher-spread securitizations amortized down and new securitizations were entered into at tighter spreads, the weighted average gross spread decreased to 1.11%. Net interest is also affected by the amortization of deferred origination costs that are capitalized on these mortgages and the provision for credit losses. Credit losses were minimal in the quarter as the Company's exposure to uninsured mortgages is declining, particularly as the Alt-A and small conventional mortgages programs run off.

Placement fees
Placement fee revenue increased 3% to $110.0 million from $107.3 million. This increase is due to the growth in origination volumes for institutional placement and the value of renewed mortgages sold to institutional investors. Total origination volumes which drive placement fees, consisting of multi-unit residential mortgages for the third-party MBS program together with mortgages originated for institutional investors, increased by 2% from 2010 to 2011. The Company also earned $9.6 million of placement fees related to renewals in the year, an increase of $6.2 million from 2010, accounting for an increase in placement fees.

Gains on deferred placement fees
Gains on deferred placement fees revenue decreased 49% to $6.7 million from $13.1 million. The decrease was due to lower volumes and tighter mortgage spreads on multi-unit residential mortgages originated for institutional MBS issuers. Volumes decreased from $1.1 billion in 2010 to $710 million, or by 34%, and the margins on these transactions narrowed from those realized in 2010.

Mortgage servicing income
Mortgage servicing income increased 12% to $82.4 million from $73.8 million. This was primarily due to the growth in the amount of the mortgage portfolio under administration, which grew by 12% year-over-year. A significant portion of this growth in the past year has been for mortgages pledged under securitization, particularly for the Company's NHA–MBS program. These mortgages earn net interest spread for the Company such that there are no servicing fees earned on these mortgages. Despite the growth of this component of the mortgage portfolio, the Company continued to earn administration fees on these mortgages and comparatively more net interest income on the trust funds it administers. These components of overall servicing income have offset the slower growth experienced in the third-party portfolio of mortgages under administration.

Mortgage investment income
Mortgage investment income increased 38% to $29.3 million from $21.2 million. The change is due primarily to the Company's larger securitization program. As the Company elects to securitize more of its origination, mortgages accumulated for sale or securitization increase and earn the Company higher interest income in the warehouse period prior to securitization. This is particularly true for the CMB, for which the warehousing period is as long as four months. The remaining change is a combination of offsetting factors, including different bond yields than in the comparative quarter (which affect the interest earned on deferred placement fees receivable), rising prime lending rates (which affect gross revenues on mortgage and loan investments), and increased amounts of mortgage and loan investments held during the comparative quarters.

Realized and unrealized gains (losses) on financial instruments
For First National, this line item typically consists of two components: (1) gains and losses related to the Company's economic hedging activities, and (2) gains and losses related to holding term assets derived using discounted cash flow methodology. Much like the short bonds which the Company uses for hedging, the term assets are affected by changes in credit markets and Government of Canada bond yields (which form the risk-free benchmarks used to price the Company's deferred placement fees receivable, mortgages designated as held for trading (primarily those funded through ABCP) and some of its mortgage and loan investments).

The Company uses short Government of Canada bonds (primarily CHT-issued bonds) together with repurchase agreements to create forward interest rate contracts to hedge interest rate risk associated with fixed rate mortgages originated for its own securitization purposes. For accounting purposes, these do not qualify as valid interest rate hedges as the bonds used are not "derivatives" but simple cash-based financial instruments. In 2010 and prior periods, gains and losses on such hedges were offset by higher or lower securitization gains as both were recognized in the same period. Under IFRS, hedging gains or losses are still recorded in the period in which the securitization debt is taken on; however, the offsetting securitization gains are not recorded. Instead, the resulting economic gain will be reflected in wider or narrower spreads on the mortgages pledged for securitization and will be realized in net interest margin over the terms of the mortgages and the related debts. In the first quarter of 2011, the Company recorded gains on these hedges of $2.3 million. In the second quarter of 2011, the Company recorded losses of $7.5 million on these hedges. Because of the significant decline in bond yields, in the third quarter of 2011 the Company recorded losses of $17.4 million on these hedges. Bond yields continued downward in the fourth quarter as issues on sovereign European debt chased Canadian investors from the equity markets into the bond markets. Although not as severe as experienced in the third quarter of 2011, the Company recorded losses of $8.4 million on its hedging activity in the fourth quarter of 2011. Accordingly, the gross spread on the related portfolio of securitized mortgages going forward will be relatively higher as the Company's testing indicates that the hedges were appropriate.

Uncertainty about the global economy, particularly in the European Union and the US, led to a significant decrease in bond yields in the year. Generally, five-year Government of Canada bond yields declined significantly from approximately 2.6% at the beginning of the year to 1.3% at the end of the year. Accordingly, the Company's deferred placement fees receivable and approximately $5 million of mortgages in mortgage and loan investments are more valuable on a comparative basis at year-end than at the end of 2010. The Company recorded gains related to holding these assets of $2.2 million in the year. Those portions of the Company's mortgages which are held at fair value (primarily those funded through ABCP), also benefited from this change in yields. The fair value of these mortgages increased as market mortgage rates decreased for similar term mortgages. Imbedded credit losses in the Company's pricing model improved and exposures to credit losses lessened as the Alt-A program continued to run off. In total for the year, the Company recorded gains in respect of ABCP funded mortgages (net of unrealized losses on related interest rate swaps) of $11.2 million.

The changes in fair value related to the Company's interest rate swaps, excluding those on the Company's ABCP-funded mortgages, had a negative impact on the Company's results. The Company recorded net losses of about $0.8 million in the year. Generally, these losses resulted from lower bond yields, which made the value of the Company's pay-fix swap positions less valuable than their market value at the end of the previous year.

Brokerage fees expense

Brokerage fees expense increased 15% to $81.5 million from $70.7 million. This increase is largely explained by the increase in single-family origination between the years, which increased by 9%. The Company's securitization policy has also affected the increase of these fees. In 2011, the Company capitalized $30.6 million of single-family broker fees to securitized mortgages. In 2010 this amount was $32.6 million. By adding these amounts back to the amounts expensed above, the Company's total expenditure on broker fees grew by approximately 8.4% from 2010 to 2011 in line with the expected 9% growth in origination volumes.

Salaries and benefits expense

Salaries and benefits expense increased 9% to $48.8 million from $44.7 million. The increase is due primarily to employee costs associated with residential mortgage origination. The Company compensates its sales staff with commissions based on origination volumes compared to quotas. Because of the increased residential origination in the year of 9%, this compensation increased by $2.6 million year-over-year. The remaining increase is for increased requirements to administer a larger portfolio of mortgages. As at December 31, 2011, the Company had 574 employees, compared to 536 as at December 31, 2010. Management salaries were paid to the two senior executives (Co-founders) who indirectly each own about 40% of FNFC's common shares. The current period's expense is as a result of the compensation arrangement executed on the closing of the initial public offering.

Interest expense

Interest expense increased 18% to $16.0 million from $13.6 million. As discussed in the "Liquidity and cash resources" section of this analysis, the Company warehouses a portion of the mortgages it originates prior to settlement with the ultimate investor or funding with a securitization vehicle. The Company uses a portion of the debenture together with a credit facility with a syndicate of banks and 30-day repurchase facilities to fund the mortgages during this period. The Company renewed the credit facility in May 2011 for a three-year term and a total commitment of $125 million. The overall interest expense has increased from the prior period due to the increased use of repurchase facilities to warehouse the larger amounts of mortgages originated for the CMB. As at December 31, 2011, the Company borrowed $664 million using these facilities, compared to $174 million as at December 31, 2010. Generally, interest expenses would have been greater but for the increased use of 30-day repurchase agreements instead of bank debt, which has saved the Company approximately 0.95% in marginal interest rates. This expense has increased by 18% despite the increased use of warehouse borrowing facilities and the increase of overnight base borrowing rates, which have risen from an average of 0.71% for 2010 to 1.20% for 2011.

Other operating and amortization of intangibles expenses

These expenses increased 12% to $36.7 million from $32.8 million. During 2011, the Company expensed $8.1 million of hedging costs associated with the direct securitization of multi-unit residential and single-family mortgages into the NHA–MBS market. In 2010, these costs amounted to $1.8 million as the Company securitized primarily floating rate mortgages which do not require such hedging. In 2011 operating expenses include $8.0 million (2010 – $9.5 million) for the amortization of intangible assets. In periods prior to 2011, this expense was incurred at the Fund level. During 2010, the Company incurred some one-time expenses totalling approximately $1.0 million related to the issuance of the debenture and the conversion to a corporation. The remaining change in these expenses represents the cost of additional servicing requirements for a larger portfolio of mortgages under administration.

Income before income taxes and EBITDA

Income before income taxes decreased 19% to $96.8 million from $120.0 million. The decrease in earnings was mainly the result of the $22.9 million of unfavourable losses related to the Company's economic hedging program. Without the impact of all gains and losses on financial instruments, the Company's financial results are approximately 2% better than those recorded in 2010. EBITDA decreased 19% to $106.6 million from $131.2 million. The decrease was due to the same factors described for income before income taxes.

Provision for income taxes

The provision for taxes decreased 12% to $26.3 million from $30.0 million. The 2010 tax provision relates to deferred taxes which the Company accrued while it operated as an income trust plus current and deferred taxes accrued at the First National level, which are included in the comparative figures. The Fund was a mutual fund trust for income tax purposes. As such, the Fund was only taxed on any amount of taxable income not distributed to unitholders. While it existed, the Fund distributed substantially all of its taxable income to its unitholders such that it did not have any current tax liabilities. To the extent that the Fund's accounting income earned from FNFLP was greater than the taxable income allocated to it by FNFLP, a deferred tax provision was recorded. No deferred tax provision was recorded for timing differences in accounting and taxable income scheduled to reverse prior to January 1, 2011; however, First National was liable for full tax on the portion of the partnership's income that would ultimately be earned by it. Generally the tax provision is lower due to the lower earnings recorded in 2011.

Operating Segment Review

The Company aggregates its business from two segments for financial reporting purposes: (i) Residential (which includes single-family residential mortgages) and (ii) Commercial (which includes multi-unit residential and commercial mortgages), as summarized below.

Operating business segments

($000s, except percent amounts)

	Residential		Commercial	
Quarter ended	December 31 2011	December 31 2010	December 31 2011	December 31 2010
Originations	**$ 9,083,331**	$ 8,323,373	**$ 2,719,100**	$ 2,187,410
Percentage change	**9.1%**		**24.3%**	
Revenue	**$ 351,497**	$ 298,011	**$ 112,523**	$ 96,248
Percentage change	**17.9%**		**16.6%**	
Income before income taxes	**$ 82,896**	$ 89,559	**$ 13,887**	$ 30,398
Percentage change	**(7.4%)**		**(54.3%)**	
Period ended	December 31 2011	December 31 2010	December 31 2011	December 31 2010
Identifiable assets	**$ 9,010,099**	$ 6,475,641	**$ 2,887,395**	$ 1,898,576
Mortgages under administration	**$ 42,251,220**	$ 36,948,100	**$ 17,347,376**	$ 16,345,032

Residential Segment

Residential revenues increased by about 18% although origination increased by about 9% between 2011 and 2010. The higher revenue relative to origination is attributable to higher interest revenue on securitized mortgages, which increased with the prime rate, which increased by 16% over 2010. The decrease in net income before income taxes is partially due to gains in fair value of $6.6 million earned in 2010. In 2011 the Company incurred $5.0 million of losses in fair value. Eliminating the effect of such revenue, net income before tax would have increased in 2011 by 6% from 2010, similar to the growth in origination. Identifiable assets have increased from those at December 31, 2010, as the Company added almost $2.0 billion of net single-family mortgages to mortgages pledged under securitization. The Company also increased the amount of securities purchased under resale agreements by approximately $300 million to hedge the larger pipeline of single-family fixed rate mortgages.

Commercial Segment

Commercial revenues increased by 17% from the prior year despite the unfavourable mark to market on the Company's hedging program on the multi-unit residential CMB program, which reduced revenue by approximately $13.5 million for the year. Eliminating the effect of such gains, revenue would have increased in 2011 by 32% from 2010, in line with the growth of origination volumes plus higher interest income on securitized mortgages, increased amounts from mortgage servicing and mortgage and loan investment interest revenue, which offset tighter margins on placement activities. Net income before tax, excluding the impact of fair value adjustments, fell by 8% or about $2.3 million from 2010 to 2011. The decrease was a result of the Company undertaking to securitize more of its origination directly. Not only was revenue offset by larger interest expenses on higher amounts of securitization debt, but hedging expenses increased by $3.9 million and warehouse interest expense increased by almost $1 million. Identifiable assets have increased from those at December 31, 2010, as the Company securitized approximately $1.0 million of multi-unit residential mortgages through the NHA–MBS market in 2011 and increased mortgages pledged under securitization.

Liquidity and Capital Resources

The Company's fundamental liquidity strategy has been to invest primarily in prime Canadian mortgages. Management's belief has always been that these mortgages are considered "AAA" by investors and will always be well bid and highly liquid. This strategy proved effective during the turmoil experienced in 2007 through 2009 when capital markets retreated and only the highest-quality assets were traded. As the Company's results have shown, First National had little, if any, trouble finding investors to purchase its mortgage origination at profitable margins. As a mortgage originator and securitizer, the Company requires significant cash resources to purchase and hold mortgages prior to selling to institutional investors or prior to arranging for term debt through the securitization markets. For this purpose, the Company uses the combination of the $175 million debenture financing and the Company's revolving bank credit facility. This aggregate indebtedness is typically used to fund: (1) mortgages accumulated for sale or securitization, (2) deferred placement fees receivable, (3) the origination costs associated with securitization, and (4) mortgage and loan investments. The Company has a credit facility with a syndicate of four banks for a total credit of $125.0 million. This facility was renewed in May 2011 for a three-year term. Bank indebtedness may also include borrowings obtained through overdraft facilities. At December 31, 2011, the Company has entered into repurchase transactions with financial institutions to borrow $664.4 million related to $688.3 million of mortgages held in mortgages accumulated for sale or securitization on the balance sheet.

At December 31, 2011, outstanding bank indebtedness at FNFLP was $80.6 million (December 31, 2010 – $23.8 million). Together with the debenture financing of $175 million (December 31, 2010 – $175 million), this "combined debt" was used to fund $162.6 million (December 31, 2010 – $139.5 million) of mortgages accumulated for sale or securitization. At December 31, 2011, the Company's other interest-yielding assets included: (1) deferred placement fee receivable of $58.5 million (December 31, 2010 – $77.4 million); and (2) mortgage and loan investments of $111.7 million (December 31, 2010 – $70.9 million). The difference between "combined debt" and the mortgages accumulated for sale or securitization funded by it, which the Company considers a proxy for true leverage, has increased between December 2010 and December 2011, and now stands at $93.0 million (December 31, 2010 – $65.7 million). This represents a debt-to-equity ratio of approximately 0.31 to 1, which the Company believes is at a conservative level. This ratio has increased from 0.25 to 1.00 as at December 31, 2010 as the Company has fully invested the proceeds of the preferred shares in $40.8 million in mortgage and loan investments, $19.2 million in cash held as collateral under securitization and approximately $30 million in net mortgages pledged under securitization.

The Company funds a large portion of its mortgage originations for institutional placement on the same day as the advance of the related mortgage. The remaining originations are funded by the Company on behalf of institutional investors or pending securitization on the day of the advance of the mortgage. On specified days, sometimes daily, the Company aggregates all mortgages warehoused to date for an institutional investor and transacts a settlement with that institutional investor. A similar process occurs prior to arranging for term funding through securitization. The Company uses a portion of the committed credit facility with the banking syndicate to fund the mortgages during this warehouse period. The credit facility is designed to be able to fund the highest balance of warehoused mortgages in a month and is normally only partially drawn.

The Company also invests in short-term mortgages, usually for six- to 18-month terms, to bridge existing borrowers in the interim period between long-term financing solutions. The banking syndicate has provided credit facilities to partially fund these investments. As these investments return cash, it will be used to pay down this bank indebtedness. The syndicate has also provided credit to finance a portion of the Company's deferred placement fees receivable and the origination costs associated with securitization as well as other miscellaneous longer-term financing needs.

A portion of the Company's capital has been employed to support its ABCP and NHA–MBS programs, primarily to provide credit enhancements as required by rating agencies. In June 2011, CMHC issued new regulations regarding the timing of mortgage title transfer to its custodian. The notice requires that cash collateral be posted immediately on pool settlement with the custodian for all mortgages not registered with the custodian on a dollar-for-dollar basis. Due to the difficulty in obtaining evidence from land registry offices on a timely basis, the Company has posted collateral for the missing registrations. At December 31, 2011, $9.3 million (December 31, 2011 – $nil) of this collateral was held by the custodian. The collateral will be repaid to the Company as registration is subsequently evidenced to the custodian on these mortgages. The other significant portion of cash collateral is the investment made on behalf of the Company's ABCP programs. As at December 31, 2011, the investment in cash collateral was $47.6 million. Although both the Alt-A and small commercial loan programs have been discontinued, no further portion of the cash collateral for these programs will be recovered by the Company until these programs terminate fully in approximately two years, as the programs are subject to minimum enhancement levels. As the Alt-A program has paid down, the ratio of defaulted mortgages to the total mortgages in the program has become skewed. In order to keep these ratios at an acceptable level for rating agencies, the Company repaid face value debt from the Trust in 2011 of approximately $10.6 million related to defaulted mortgages. The Company received $15.6 million (face value) on the liquidation of previously repurchased mortgages during the same period, experiencing credit losses at expected levels. At December 31, 2011, the Company employs an assumption for the fair value of credit losses in the Alt-A program of 0.70% per annum. To date, this assumption has been more than enough to absorb all actual losses experienced in the program. The Company believes that prudent management of this program will continue to require some level of liquidity from the Company throughout its remaining term.

As demonstrated previously, the Company continues to see strong demand for its mortgage product from institutional investors and liquidity from bank-sponsored commercial paper conduits. The Company's strategy of using diverse funding sources has allowed the Company to thrive, producing record profitability in 2009 and 2010. By focusing on the prime mortgage market, the Company believes it will continue to attract bids for mortgages as its institutional customers seek government-insured assets for investment purposes. The Company also believes it can manage any liquidity issues that would arise from a year-long slowdown in origination volumes. Based on cash flow received in the fourth quarter of 2011, the Company will receive approximately $66 million of cash, on an annualized basis, from its servicing operations and $100 million of annualized cash flow from securitization transaction spread and deferred placement fees receivable. Together, on an after-tax basis, this $120 million of annual cash flow would be more than sufficient to support the indicated annual dividends of $75 million on the common shares and the $4.65 million on the preferred shares. Although this is a simplified analysis, it does highlight the sustainability of the Company's business model and dividend policy through periods of economic weakness.

As described earlier, the Company issued 4,000,000 Series 1 preferred shares at a price of $25.00 per share for gross proceeds of $100 million, before issue expenses. The net proceeds of $96.7 million were invested in FNFLP as partners' capital. The issuance gives the Company additional capital which will allow it to undertake greater volumes of securitization transactions directly and reduce reliance on institutional investors as a funding source.

The Company's Board of Directors has elected to pay dividends, when declared, on a monthly basis for the outstanding common shares and on a quarterly basis for the outstanding preferred shares. For purposes of the enhanced dividend tax credit rules contained in the *Income Tax Act* (Canada) and any corresponding provincial and territorial tax legislation, all dividends (and deemed dividends) paid by us to Canadian residents on our common and preferred shares after December 31, 2010 are designated as "eligible dividends". Unless stated otherwise, all dividends (and deemed dividends) paid by us hereafter are designated as "eligible dividends" for the purposes of such rules. For the preferred shares, the Company has elected to pay any tax under Part VI.1 of the *Income Tax Act*, such that corporate holders of the shares will not be required to pay tax under Part VI.1 of the *Income Tax Act* on dividends received on such shares.

Financial Instruments and Risk Management

The Company has elected to treat deferred placement fees receivable, the portion of mortgages pledged under securitization sold to ABCP conduits, and several mortgages within mortgage and loan investments as financial assets at "fair value through profit or loss" such that changes in market value are recorded in the statement of income. Effectively, these assets are treated much like bonds, earning the Company a coupon at the discount rates used by the Company. The discount rates used represent the interest rate associated with a risk-free bond of the same duration plus a premium for the risk/uncertainty of the asset's residual cash flows. Accordingly, as rates in the bond market change, so will the carrying value of these assets. These changes may be significant (favourable and unfavourable) from quarter to quarter. The Company enters into fixed for float swaps to manage the interest rate exposure of fixed mortgages sold to ABCP conduits. These instruments will also be treated as fair value through profit or loss. While the Company has attempted to exactly match the principal balances of the fixed mortgages over the next five-year period to the notional swap values for the same period, there will be differences in these amounts. Any favourable or unfavourable amounts will be recorded in the statement of earnings each quarter.

The Company believes its hedging policies are suitably disciplined such that the interest rate risk of holding mortgages prior to securitization is mitigated. From an accounting perspective, any gains or losses on these instruments are recorded in the current period as the Company's "hedging" strategy does not qualify as hedging for accounting purposes. The Company uses 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 transferred to the securitization vehicle and the matched term debt is arranged. As interest rates change, the value of these short bonds will vary inversely with the value of the related mortgages. As interest rates increase, a gain will be recorded on the bonds which should be offset by a tighter interest rate spread between the interest rates on mortgage and the securitization debt. This spread will be earned over the term of the related mortgages. For single-family mortgages, primarily mortgages for the Company's own securitization programs, only a portion of the mortgage 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 hedged is the expected value of mortgages funding within the next 120 days (120 days being the standard maximum rate hold period available for the mortgages). As at December 31, 2011, the Company has $380.3 million of notional forward bond positions related to its single-family programs. For multi-unit residential and commercial mortgages, the Company assumes all mortgages committed will fund and hedges each mortgage individually. This includes mortgages committed for the CMB program as well as mortgages for transfer to the Company's other securitization vehicles. As at December 31, 2011, the Company had entered into $245.8 million in notional value forward bond sales for this segment. The change in mark-to-market value together with realized losses totalled $31.0 million on the notional hedges transacted in the period January 1, 2011 to December 31, 2011. This amount has been expensed through the statement of income.

Upon the settlement of the debenture issuance, the Company entered into a float-for-fix swap. The swap requires the Company to pay CDOR+2.134% on a notional amount of $175 million and to receive the debenture interest coupon (5.07%) semi-annually. This effectively converts the fixed rate semi-annual debenture-based loan payable into a floating rate monthly resetting note payable. Since the date when this swap was entered into, five-year interest rates have decreased pursuant to global economic issues and the value of this swap has increased to $9.7 million as at December 31, 2011. The

Company has documented this swap as a hedge for accounting purposes as the fixed leg of the swap exactly matches the cash flow obligations under the debenture. Effectively, the unrealized gain of $9.7 million on the swap has been excluded from earnings and been applied to increase the carrying value of the debenture note payable. The Company is also a party to four amortizing fix-for-float rate swaps that economically hedge the interest rate exposure related to certain mortgages held on the balance sheet that the Company has originated as replacement assets for its CMB activities. As at December 31, 2011, the aggregate notional value of these swaps was $48.6 million. Market swap rates decreased during the year so the value of these swaps decreased by approximately $0.8 million. The amortizing swaps mature between September 2013 and December 2021.

As described above, the Company employs various strategies to reduce interest rate risk. In the normal course of business, the Company takes some credit spread risk. This is the risk that the credit spread at which a mortgage is originated changes between the date of commitment of that mortgage and the date of sale or securitization. This can be illustrated by the Company's experience with commercial mortgages originated for the CMBS market in the spring of 2007. These mortgages were originated at credit spreads designed to be profitable to the Company when sold to a bank-sponsored CMBS conduit. Unfortunately for the Company, when these mortgages funded, the CMBS market had shut down. The alternative to this channel was more expensive as credit spreads elsewhere in the marketplace for this type of mortgage had moved wider. The Company adjusted for market-suggested increases in credit spreads in 2007 and 2008, adjusting the value of the mortgages downward. In 2009, the economic environment remained weak but did not worsen from what it was at the end of 2008. Overall credit spreads stopped widening such that the Company applied the same spreads to these mortgages and the Company did not record any additional unrealized loss or gains related to credit spread movement. Despite entering into effective economic interest rate hedges, the Company's exposure to credit spreads remained. This risk is inherent in the Company's business model and cannot be economically hedged.

The same exposure to risk is inherent in the Company's securitization through ABCP. The Company is exposed to the risk that 30-day ABCP rates are greater than 30-day BA rates. Prior to the financial crisis, it considered this a low risk given the quality of the assets securitized, the amount of credit enhancements provided by the Company and the strong covenant of the bank-sponsored conduits with which the Company transacted. In 2008, 30-day ABCP traded at approximately 1.10 percentage points over BAs but by the end of December 2011, it was priced at a discount to BAs. At the same time the Company has leveraged on changing credit spreads. This has been demonstrated through the increase in volume and profitability of the NHA–MBS program and significant increases in gains on deferred placement fees from the sale of prime insured mortgages.

As at December 31, 2011, the Company has various exposures to changing credit spreads. The Company has $21 million of exposure related to commercial mortgages originated originally for the CMBS market. In mortgages accumulated for sale or securitization there are $847 million of mortgages that are susceptible to some degree of changing credit spreads.

Capital Expenditures

A significant portion of First National's business model consists of the origination and placement or securitization of financial assets. Generally placement activities do not require much capital investment as the Company acts primarily in the capacity of a broker. On the other hand, the undertaking of securitization transactions requires sometimes significant amounts of the Company's own capital. This capital is provided in the form of cash collateral, credit enhancements, and the upfront funding of broker fees and other origination costs. These are described more fully in the Liquidity and Capital Resources section above. For fixed assets, the business requires capital expenditures on technology (both software and hardware), leasehold improvements and office furniture. During the year ended December 31, 2011, the Company purchased new computers and office and communication equipment to support primarily its single-family residential business. Going forward, the Company expects capital expenditures on fixed assets will be approximately $2.0 million annually.

Summary of Contractual Obligations

The Company's long-term obligations include five- to 10-year premises leases for its four offices across Canada, and its obligations for the ongoing servicing of mortgages sold to securitization conduits and mortgages related to purchased servicing rights. The Company sells its mortgages to securitization conduits on a fully-serviced basis, and is responsible for the collection of the principal and interest payments on behalf of the conduits, including the management and collection of mortgages in arrears.

($000s)	Payments due by period				
	Total	0–1 year	2–3 years	4–5 years	After 5 years
Lease obligations	$ 17,552	$ 3,758	$ 6,661	$ 5,894	$ 1,239
Total contractual obligations	$ 17,552	$ 3,758	$ 6,661	$ 5,894	$ 1,239

Critical Accounting Policies and Estimates

The Company prepares its financial statements in accordance with IFRS, which requires management to make estimates, judgments and assumptions that management believes are reasonable based upon the information available. These estimates, judgments and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Management bases its estimates on historical experience and other assumptions which it believes to be reasonable under the circumstances. Management also evaluates its estimates on an ongoing basis.

The significant accounting policies of First National are described in Note 2 to the Company's audited financial statements as at December 31, 2011. The policies which First National believes are the most critical to aid in fully understanding and evaluating its reported financial results include the determination of the gains on deferred placement fees and the impact of fair value accounting on financial instruments.

The Company uses estimates in valuing its gain or loss on the sale of its mortgages placed with institutions earning a deferred placement fee. Under IFRS, valuing a gain on deferred placement requires the use of estimates to determine the fair value of the retained interest (derived from the present value of expected future cash flows) in the mortgages. These retained interests are reflected on the Company's balance sheet as deferred placement fees receivable. The key assumptions used in the valuation of gains on deferred placement fees are prepayment rates and the discount rate used to present value future expected cash flows. The annual rate of unscheduled principal payments is determined by reviewing portfolio prepayment experience on a monthly basis. The Company uses different rates for its various programs that average approximately 15% for single-family mortgages. The Company assumes there is virtually no prepayment on multi-residential fixed rate mortgages. Actual prepayment experience has been consistent with these assumptions.

On a quarterly basis, the Company reviews the estimates used to ensure their appropriateness and monitors the performance statistics of the relevant mortgage portfolios to adjust and improve these estimates. The estimates used reflect the expected performance of the mortgage portfolio over the lives of the mortgages. The assumptions underlying the estimates used for the year ended December 31, 2011, continue to be consistent with those used for the year ended December 31, 2010 and the quarters ended September 30, 2011, June 30, 2011 and March 31, 2011.

The Company has elected to treat its financial assets and liabilities, including deferred placement fees receivable, ABCP-funded mortgages, some mortgage and loan investments and bonds sold short at fair value through profit or loss. Essentially, this policy requires the Company to record changes in the fair value of these instruments in the current period's earnings. The Company's assets and liabilities are such that the Company must use valuation techniques based on assumptions that are not fully supported by observable market prices or rates in most cases. Much like the valuation of deferred placement fees receivable described above, the Company's method of determining the fair value of its mortgages funded by ABCP has a significant impact on earnings. The Company uses different prepayment rates for its various programs that average approximately 15% for single-family mortgages. The Company assumes there is virtually no prepayment on multi-residential fixed rate mortgages. Actual prepayment experience has been consistent with these assumptions. It has also assumed discount rates based on Government of Canada bond yields plus a spread that the Company believes would enable a third party to purchase the mortgages and make a normal profit margin for the risk involved.

Future Accounting Changes

The Company has adopted IFRS as at January 1, 2010. The following new IFRS pronouncements have been issued and although not yet effective, may have a future impact on the Company.

IFRS 9 – Financial Instruments

As of January 1, 2015, the Company will be required to adopt this standard, which is the first phase of the International Accounting Standard Board's ("IASB") project to replace IAS 39 – *Financial Instruments: Recognition and Measurement*. IFRS 9 provides new requirements for how an entity should classify and measure financial assets and liabilities that are in the scope of IAS 39. Management is currently evaluating the potential impact that the adoption of IFRS 9 will have on the Company's consolidated financial statements. Of potential relevance to the Company is a revised section on hedge accounting designed to make the reporting of hedging activity more straightforward. Among other changes, the hedging standard will permit the use of a financial asset or liability as a hedging instrument. The current standard requires that only a derivative can be identified as a hedging instrument. As the Company has historically used short bonds (a financial liability) as a hedging instrument, the change could affect the nature of the Company's reporting in this respect.

IFRS 10 – Consolidated Financial Statements

As of January 1, 2013, the IASB introduced a single model for consolidating subsidiaries using a control model. This standard addresses in particular the control of special purpose entities. There will be little impact to the Company as it currently consolidates its special purpose entities fully.

IFRS 11 – Joint Arrangements

As of January 1, 2013, the IASB has expanded the definition of a joint venture. The Company would be required to account for joint ventures by the equity method as opposed to proportionate consolidation.

IFRS 12 – Disclosure of Interests in Other Entities
As of January 1, 2013, the Company will be required to make new disclosures on its off-balance sheet activities including those with special purpose entities.

IFRS 13 – Fair Value Measurement
As of January 1, 2013, the Company will be required to adopt this standard, which provides a framework for the application of fair value to those assets and liabilities qualifying or permitted to be carried at fair value. The Company believes its current measurement of fair value is appropriate and there will be little impact.

IAS 27 – Separate Financial Statements
As of January 1, 2013, this standard will only prescribe the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements, and thus will have limited impact for the Company.

IAS 28 – Investments in Associates
As of January 1, 2013, this standard has been amended to correspond to changes in IFRS 10, 11 and 12, listed above, providing guidance for investments in associates. As described above, there should be little effect on the Company.

Controls over financial reporting
Management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with reporting standards; however, because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements on a timely basis.

During the Company's transition to IFRS and the Conversion to a corporation, management identified and subsequently implemented certain changes to accounting processes and procedures in order to comply with IFRS. These changes were most significant for the following financial statement components: reporting for mortgages pledged under securitization; reporting for debt related to securitized mortgages; reporting for both interest revenue – securitized mortgages and interest expense – securitized mortgages; reporting for deferred income taxes; reporting for consolidation of special purpose entities; and the restatement of 2010 comparative figures to incorporate IFRS and the conversion from an income trust structure. Because of these changes, management revised existing internal controls and designed and implemented new internal controls over financial reporting to provide reasonable assurance that the risk of material misstatements in the Company's financial reporting has been mitigated. There were no other changes made in the Company's internal controls over financial reporting during the year ended December 31, 2011 that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

Management evaluated, under the supervision of and with the participation of the Chairman and President, and Chief Financial Officer, the effectiveness of the Company's internal control over financial reporting based on the criteria set forth in *Internal Control over Financial Reporting – Guidance for Smaller Public Companies* issued by the Committee of Sponsoring Organizations of the Treadway Commission and, based on that evaluation, concluded that the Company's internal control over financial reporting was effective as of December 31, 2011 and that there were no material weaknesses that have been identified in the Company's internal control over financial reporting as of December 31, 2011. No changes were made in the Company's internal controls over financial reporting during the year ended December 31, 2011, except as described above related to IFRS and the Conversion, that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

Risk and Uncertainties Affecting the Business

The business, financial condition and results of operations of the Company are subject to a number of risks and uncertainties, and are affected by a number of factors outside the control of management of the Company including: ability to sustain performance and growth, reliance on sources of funding, concentration of institutional investors, reliance on independent mortgage brokers, changes in interest rates, repurchase obligations and breach of representations and warranties on mortgage sales, risk of servicer termination events and trigger events on cash collateral and retained interests, reliance on multi-unit residential and commercial mortgages, general economic conditions, government regulation, competition, reliance on mortgage insurers, reliance on key personnel, conduct and compensation of independent mortgage brokers, failure or unavailability of computer and data processing systems and software, insufficient insurance coverage, change in or loss of ratings, impact of natural disasters and other events, environmental liability, and risk related to Alt-A mortgages, which experience higher arrears rates and credit losses than prime mortgages. In addition, risks associated with the structure of FNFC include those related to the dependence on FNFLP, leverage and restrictive covenants, dividends which are not guaranteed and could fluctuate with FNFLP's performance, restrictions on potential growth, the market price of FNFC shares, statutory remedies, control of the Company and contractual restrictions, and income tax matters. Risk and risk exposure are managed through a combination of insurance, a system of internal controls and sound operating practices. The Company's key business model is to originate primarily prime mortgages and find funding through various channels to earn ongoing servicing or spread income. For the single-family residential segment, the Company relies on independent mortgage brokers for origination and several large institutional investors for sources of funding. These relationships are critical to the Company's success. For a more complete discussion of the risks affecting the Company's business, reference should be made to the Annual Information Form of the Company.

Forward-Looking Information

Forward-looking information is included in this MD&A. In some cases, forward-looking information can be identified by the use of terms such as "may", "will", "should", "expect", "plan", "anticipate", "believe", "intend", "estimate", "predict", "potential", "continue" or other similar expressions concerning matters that are not historical facts. Forward-looking information may relate to management's future outlook and anticipated events or results, and may include statements or information regarding the future financial position, business strategy and strategic goals, product development activities, projected costs and capital expenditures, financial results, risk management strategies, hedging activities, geographic expansion, licensing plans, taxes and other plans and objectives of or involving the Company. Particularly, information regarding growth objectives, any increase in mortgages under administration, future use of securitization vehicles, industry trends and future revenues is forward-looking information. Forward-looking information is based on certain factors and assumptions regarding, among other things, interest rate changes and responses to such changes, the demand for institutionally placed and securitized mortgages, the status of the applicable regulatory regime and the use of mortgage brokers for single-family residential mortgages. This forward-looking information should not be read as providing guarantees of future performance or results, and will not necessarily be an accurate indication of whether or not, or the times by which, those results will be achieved. While management considers these assumptions to be reasonable based on information currently available to it, they may prove to be incorrect. Forward looking-information is subject to certain factors, including risks and uncertainties, which could cause actual results to differ materially from what management currently expects. These factors include reliance on sources of funding, concentration of institutional investors, reliance on independent mortgage brokers and changes in interest rates outlined under "Risk and Uncertainties Affecting the Business". In evaluating this information, the reader should specifically consider various factors, including the risks outlined under "Risk and Uncertainties Affecting the Business", which may cause actual events or results to differ materially from any forward-looking information. The forward-looking information contained in this discussion represents management's expectations as of February 28, 2012, and is subject to change after such date. However, management and the Company disclaim any intention or obligation to update or revise any forward-looking information, whether as a result of new information, future events or otherwise, except as required under applicable securities regulations.

Outlook

The global economic outlook turned negative during 2011. Epitomized perhaps by Standard & Poor's downgrade of the United States government's credit rating in August, the latter half of the year featured increased recessionary pressures, global financial turmoil and volatile equity markets. The interest rate environment, which began to rise in the first quarter of 2011, reversed course in the second quarter and then fell sharply in the third quarter as investors fled to the safety of the bond markets, driving down bond yields. Yet the Canadian real estate market remained strong throughout the year and the Company was able to originate near record levels of new mortgages. First National took advantage of this origination and its greater capital base by securitizing more than $4 billion of mortgages. Although most of the origination costs for these mortgages have been capitalized, the costs of internal underwriting, large hedge losses, and significant fees paid to register the mortgages with the title custodian, have all been expensed. The spread from this increased securitization activity will benefit the Company for the five- and 10-year terms of these transactions going forward.

Given the recent market turmoil, the large Canadian banks have acted to increase mortgage spreads in order to maintain profitability on these assets. This has been evidenced over the past quarter as floating-rate single-family mortgages that had been priced at a 0.70% discount to prime in the summer are now being offered at no discount to prime. Similarly, fixed-rate mortgages have recently been priced so as to increase spreads to a range of 1.75% to 2.00%. These increases will enable the Company's securitization activities to be more profitable. The five large banks are also making the transition to IFRS this year. While this may not have a large impact on their mortgage business, the Company has seen smaller competitors exit the market or slow down origination in the face of higher capital requirements for securitization, which is a consequence of IFRS.

Management is very pleased with its volume of originations for 2011. For 2012, management sees overall origination volumes remaining at levels comparable or slightly lower than 2011 origination as market activity slows down. The Company forecasts that MUA, currently at $59.6 billion, will continue to grow and produce higher income and cash flow. The wider mortgage spreads on the Company's core products, prime mortgages, will give the Company the opportunity to continue to pursue more direct securitization. Together with the large investment in the portfolio of mortgages under securitization at the end of December 31, 2011, First National expects increased cash flow profitability in 2012.

Management's Responsibility for Financial Reporting

The accompanying consolidated financial statements of First National Financial Corporation for the period from January 1, 2011 to December 31, 2011 and all information in this annual report are the responsibility of management.

The financial statements have been prepared by management in accordance with International Financial Reporting Standards. The preparation of these financial statements requires management to make estimates and assumptions that affect certain reported amounts which management believes are reasonable.

The Audit Committee of the Board of Directors has reviewed in detail the financial statements with management and the independent auditors. The Board of Directors has approved the financial statements on the recommendation of the Audit Committee.

Ernst & Young LLP, an independent auditing firm, has audited First National Financial Corporation's 2011 consolidated financial statements in accordance with International Financial Reporting Standards and has provided an independent audit opinion. The auditors have full and unrestricted access to the Audit Committee to discuss the results of their audit.

Stephen J. R. Smith
Chairman and President

Robert A. Inglis
Chief Financial Officer

Independent Auditors' Report

To the Shareholders of
First National Financial Corporation

We have audited the accompanying consolidated financial statements of First National Financial Corporation, which comprise the consolidated statements of financial position as at December 31, 2011 and 2010, and January 1, 2010, and the consolidated statements of comprehensive income and retained earnings, changes in shareholders' equity and cash flows for the years ended December 31, 2011 and 2010, and a summary of significant accounting policies and other explanatory information.

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

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

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

Ernst & Young LLP

Chartered Accountants
Licensed Public Accountants

Toronto, Canada,
February 28, 2012

First National Financial Corporation

Consolidated Statements of Financial Position

($000s)

As at	Notes	December 31 2011	December 31 2010 [1]	January 1 2010 [1]
ASSETS				
Restricted cash	3	**$ 230,519**	$ 156,198	$ 73,440
Accounts receivable and sundry		**61,558**	50,787	46,972
Securities purchased under resale agreements and owned	15	**657,626**	426,336	333,705
Mortgages accumulated for sale or securitization	5	**850,938**	318,136	382,859
Mortgages pledged under securitization	3	**9,761,921**	7,193,961	5,540,794
Deferred placement fees receivable	4	**58,509**	77,410	90,268
Cash held as collateral for securitization	3	**56,882**	37,730	43,709
Purchased mortgage servicing rights	8	**4,771**	5,766	6,607
Mortgage and loan investments	6	**180,872**	70,911	54,737
Income taxes recoverable	18	**3,556**	–	–
Other assets	7	**60,118**	66,758	76,769
Total assets		**$ 11,927,270**	$ 8,403,993	6,649,860
LIABILITIES AND EQUITY				
Liabilities				
Bank indebtedness	10	**$ 80,608**	$ 9,896	$ 203,758
Obligations related to securities and mortgages sold under repurchase agreements	16	**664,424**	174,258	221,937
Accounts payable and accrued liabilities		**57,692**	63,998	76,712
Securities sold under repurchase agreements and sold short	15	**659,299**	424,673	332,427
Debt related to securitized and participation mortgages	11	**9,957,219**	7,274,482	5,536,394
Debenture loan payable	13	**184,689**	178,849	–
Income taxes payable	18	**–**	8,940	14,231
Deferred tax liabilities	18	**30,300**	34,721	30,519
Total liabilities		**$ 11,634,231**	$ 8,169,817	$ 6,415,978
Equity				
Common shares	17	**$ 122,671**	$ 122,671	$ 122,671
Preferred shares	17	**97,394**	–	–
Retained earnings		**72,974**	111,505	111,211
Total equity		**293,039**	234,176	233,882
Total liabilities and equity		**$ 11,927,270**	$ 8,403,993	$ 6,649,860

See accompanying notes

[1] The 2010 comparative figures have been restated to account for the Conversion. See notes 1 and 23.

John Brough

Robert Mitchell

First National Financial Corporation

Consolidated Statements of Comprehensive Income and Retained Earnings

($000s, except earnings per unit)

Years ended December 31	Notes	2011	2010 [1]
REVENUE			
Interest revenue – securitized mortgages		**$ 254,118**	$ 171,526
Interest expense – securitized mortgages		**(184,291)**	(112,530)
Net interest – securitized mortgages	3	**69,827**	58,996
Placement fees		**110,041**	107,292
Gains on deferred placement fees	4	**6,663**	13,123
Mortgage investment income		**29,311**	21,192
Mortgage servicing income		**82,372**	73,846
Realized and unrealized gains (losses) on financial instruments		**(18,485)**	7,280
		279,729	281,729
EXPENSES			
Brokerage fees		**81,480**	70,718
Salaries and benefits		**48,808**	44,653
Interest		**15,998**	13,613
Other operating		**28,692**	23,320
Amortization of intangible assets		**7,968**	9,468
		182,946	161,772
Income before income taxes		**96,783**	119,957
Income tax expense	18	**26,292**	30,040
Net income and comprehensive income for the year		**70,491**	89,917
Retained earnings, beginning of year		**111,505**	111,211
Less: dividends/distributions declared		**(109,022)**	(89,623)
Retained earnings, end of year		**$ 72,974**	$ 111,505
Earnings per share			
Basic	17	**$ 1.10**	$ 1.50

See accompanying notes

[1] The 2010 comparative figures have been restated to account for the Conversion. See notes 1 and 23.

First National Financial Corporation

Consolidated Statements of Changes in Shareholders' Equity

($000s)

	Common shares	Preferred shares	Retained earnings	Total shareholders' equity
Balance at January 1, 2011 [1]	$ 122,671	$ –	$ 111,505	$ 234,176
Comprehensive income	–	–	70,491	70,491
Issuance of preferred shares	–	97,394	–	97,394
Dividends paid or declared	–	–	(109,022)	(109,022)
Balance at December 31, 2011	**$ 122,671**	**$ 97,394**	**$ 72,974**	**$ 293,039**

	Common shares	Preferred shares	Retained earnings	Total shareholders' equity
Balance at January 1, 2010 [1]	$ 122,671	$ –	$ 111,211	$ 233,882
Comprehensive income	–	–	89,917	89,917
Distributions paid or declared	–	–	(89,623)	(89,623)
Balance at December 31, 2010	$ 122,671	$ –	$ 111,505	$ 234,176

See accompanying notes

[1] The 2010 comparative figures have been restated to account for the Conversion. See notes 1 and 23.

First National Financial Corporation

Consolidated Statements of Cash Flows

($000s)

Years ended December 31	2011	2010 [1]
OPERATING ACTIVITIES		
Net income for the year	$ 70,491	$ 89,917
Add (deduct) items not affecting cash:		
Deferred income tax expense	(3,508)	4,202
Non-cash portion of gains on deferred placement fees	(4,720)	(9,566)
Increase in restricted cash	(74,321)	(82,758)
Net investment in mortgages pledged under securitization	(2,569,632)	(1,670,042)
Net increase in debt related to securitized mortgages	2,613,535	1,738,088
Amortization of deferred placement fees receivable	24,771	23,355
Amortization of purchased mortgage servicing rights	995	841
Amortization of property, plant and equipment	1,856	1,796
Amortization of intangible assets	7,968	9,468
Unrealized gains on financial instruments	(3,846)	(6,698)
	63,589	98,603
Net change in non-cash working capital balances related to operations	(519,947)	66,720
Cash provided by (used in) operating activities	$ (456,358)	$ 165,323
INVESTING ACTIVITIES		
Additions to property, plant and equipment	$ (3,184)	$ (1,253)
Investment of cash held as collateral under securitization	(19,152)	5,979
Investment in mortgage and loan investments	(238,476)	(67,170)
Repayment of mortgage and loan investments	129,580	53,642
Cash used in investing activities	$ (131,232)	$ (8,802)
FINANCING ACTIVITIES		
Dividends/distributions paid	$ (133,600)	$ (89,623)
Issuance of preferred shares	96,481	–
Obligations related to securities and mortgages sold under repurchase agreements	490,166	(47,679)
Proceeds from debenture loan	–	175,000
Debt related to participation mortgages	69,202	–
Securities purchased under resale agreements and owned, net	(231,290)	(92,631)
Securities sold under repurchase agreements and sold short, net	225,919	92,274
Cash provided by financing activities	$ 516,878	$ 37,341
Net decrease (increase) in bank indebtedness during the year	$ (70,712)	$ 193,862
Bank indebtedness, beginning of year	(9,896)	(203,758)
Bank indebtedness, end of year	$ (80,608)	$ (9,896)
Supplemental cash flow information		
Interest received	$ 261,027	$ 220,349
Interest paid	187,933	116,782
Income taxes paid	33,356	33,387

See accompanying notes

[1] The 2010 comparative figures have been restated to account for the Conversion. See notes 1 and 23.

Notes to Consolidated Financial Statements

December 31, 2011 and 2010

($000s, except per unit amounts or unless otherwise noted)

Note 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 $59 billion in mortgages under administration, FNFLP is an originator and underwriter of mortgages and a significant participant in the mortgage broker distribution channel. Pursuant to a Plan of Arrangement [the "Arrangement"] and an amalgamation [the "Amalgamation"] effective January 1, 2011, the Corporation succeeded First National Financial Income Fund [the "Fund"] as the public holding company invested in FNFLP. The Arrangement and Amalgamation [together the "Conversion"] were used to convert the Fund into a corporate structure. The most significant steps involved in the Conversion were:

- A new company, First National Financial Inc. ["FNFI"], was formed;
- Unitholders of the Fund exchanged their 12,681,113 Class A units in the Fund for shares in FNFI on a one-for-one basis;
- The pre-Arrangement shareholders of the Corporation [the "Co-founders"] exchanged 47,286,316 shares in the Corporation for 47,286,316 shares of FNFI with the result that the Corporation became a wholly-owned subsidiary of FNFI;
- The Fund and First National Financial Operating Trust were wound up; and
- The Corporation and FNFI were amalgamated and continued under the name "First National Financial Corporation".

Effectively, the Conversion reorganized the ownership interests in FNFLP such that all such interests are now consolidated and held through the Corporation in the same ratio as previously held by the Fund and by the Co-founders. Prior to the initial public offering of the Fund [the "IPO"] in June 2006, the Corporation owned and operated the business. Concurrent with the IPO, the business was transferred from the Corporation to FNFLP such that the Corporation then operated as a privately held holding company which owned a direct interest of 80.03% in FNFLP. At that time, the Fund indirectly held the non-controlling interest in FNFLP of 19.97%. Given the history of the Corporation's relationship with FNFLP and the non-arm's length nature of the Conversion, the Corporation has accounted for these transactions as a business combination under common control using the pooling of interests method. Accordingly, the Corporation's consolidated financial statements reflect the combined activities of the Fund and the Corporation prior to the Conversion [including the consolidation of FNFLP]. Immediately prior to the Conversion, residual assets and liabilities of the Corporation were distributed and settled so that as of the Conversion date, the consolidated statement of financial position of the Corporation substantially reflects the assets and liabilities of FNFLP at book value, plus the intangible assets represented by the excess of the purchase price paid by the Fund over the carrying value of its share of the net assets of FNFLP at the IPO date and deferred tax liabilities related to temporary differences between the book value and tax basis of the carrying value of the Fund's investment in FNFLP. In effect this accounting treatment assumes, for comparative financial reporting purposes, that the Conversion occurred at the time of the IPO. The Co-founders have provided indemnities to the Corporation to protect the current shareholders of the Corporation from any unrecorded liabilities incurred by the Corporation in the period between the IPO and January 1, 2011.

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 ["TSX"] under the symbols FN and FN.PR.A, respectively.

Note 2

Significant Accounting Policies

2.1 Basis of preparation

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ["IFRS"] as issued by the International Accounting Standards Board [the "IASB"] [see note 23 for IFRS transition disclosures]. The consolidated financial statements have been prepared on a historical cost basis, except for derivative financial instruments and financial assets and financial liabilities, which are recorded at fair value through profit or loss and measured at fair value. The carrying values of recognized assets and liabilities, that are hedged items in fair value hedges, and otherwise carried at amortized cost, are adjusted to record changes in fair value attributable to the risks that are being hedged. The consolidated financial statements are presented in Canadian dollars and all values are rounded to the nearest thousands, except when otherwise indicated. The consolidated financial statements were authorized for issue by the Board of Directors on February 28, 2012.

2.2 Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiaries, including FNFLP, First National Financial GP Corporation [the general partner of FNFLP] and FNFC Trust, a special purpose entity ["SPE"] which is used to manage undivided co-ownership interests in mortgage assets and fund these with Asset-Backed Commercial Paper ["ABCP"]. The consolidated financial statements have been prepared using consistent accounting policies for like transactions and other events in similar circumstances.

All inter-company balances and revenues and expenses have been eliminated on consolidation.

2.3 Use of estimates

The preparation of 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 liabilities at fair value.

2.4 First-time application of IFRS

The Company has applied IFRS to its financial reporting with effect from January 1, 2010, the date of transition, in accordance with the transitional provisions set out in IFRS 1, "First-time Adoption of International Financial Reporting Standards" ["IFRS 1"]. Previously, the Company had prepared its financial statements in conformity with Canadian generally accepted accounting principles ["GAAP"]. The Company's consolidated financial statements for the year ended December 31, 2011 are the first annual financial statements that comply with IFRS. IFRS 1 requires first-time adopters to retrospectively apply all effective IFRS as of the first annual reporting date. IFRS 1 also provides certain optional and mandatory exemptions for the first-time IFRS adopters. The mandatory exemptions are as follows:

Mandatory exemptions

Derecognition of financial assets and financial liabilities The Company has elected not to re-recognize any financial assets and financial liabilities derecognized before January 1, 2004.

Hedge accounting Hedge accounting can only be applied prospectively from the transition date of January 1, 2010 to transactions that satisfy the hedge accounting criteria in IAS 39 at that date. Hedging relationships cannot be designated retrospectively and the supporting documentation cannot be created retrospectively. As a result, only hedging relationships that satisfied the hedge accounting criteria as of the transition date are reflected as hedges in the Company's results under IFRS.

Estimates The estimates at January 1, 2010 and at December 31, 2010 are consistent with those made for the same dates in accordance with Canadian GAAP, after adjustments to reflect any differences in accounting policies.

2.5 Significant accounting policies

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 of its originated mortgages. 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 statement of financial position, unless:

[i] substantially all 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 revenue is recognized over the term of the mortgages.

Interest revenue – securitized mortgages represents interest received and accrued on mortgage payments by borrowers and is net of the amortization of capitalized origination fees.

Interest expense – securitized mortgages represents financing costs to fund these mortgages, net of the amortization of debt discounts or premiums. Both capitalized origination fees and debt discounts or premiums are amortized on an effective yield basis over the term of the related mortgages/debt.

Derecognition A financial asset is derecognized when:

- The right to receive cash flows from the asset has expired;
- The Company has transferred its rights to receive cash flows from the assets or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a "pass-through" arrangement; and either [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.

When the Company has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all of the risks and rewards of the asset nor transferred control of the asset, the asset is recognized to the extent of the Company's continuing involvement in the asset. In that case, the Company also recognizes an associated liability.

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 of the risks and rewards of ownership of these mortgages, it has derecognized 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 fair 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.

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 mortgages pledged under securitizations, 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 normal 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.

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 relating to the mortgages recorded at fair value are expensed as incurred and brokerage fees relating to mortgages recorded at amortized cost are deferred 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. The Company has a continuous involvement in these mortgages, including the right to receive future cash flows arising from these mortgages. Mortgages pledged under securitization [except for mortgages funded with bank-sponsored ABCP programs] have been classified as loans and receivables and are measured at their amortized cost using the effective yield method. Mortgages funded under bank-sponsored ABCP programs are classified as fair value through profit or loss and recorded at fair value. Origination costs, such as brokerage fees and timely payment guarantee fees 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 on the raising of these debts that is directly attributable to the acquisition of 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 institution's investment. The Company has retained various rights to the mortgages and a proportionately larger share of the interest earned on these mortgages, such that the full mortgage has been recorded on the Company's statement 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 fair value through profit or loss and are recorded at fair value. These mortgages are held for terms usually not exceeding 90 days.

The Company classifies mortgages that are funded for its own securitization programs as loans and receivables and carries these mortgages at amortized cost.

Securities sold short and securities purchased under resale agreements

Securities sold short consist of the short sale of a bond. Bonds purchased under resale agreements consist of the purchase of a bond with the commitment by 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 mortgages that it intends to securitize.

Bonds sold short are classified as fair value through profit or loss and are recorded at fair value. The accrued coupon on bonds sold short is recorded as hedge expense. 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.

Securities owned and securities sold under repurchase agreements

The Company purchases bonds and enters into bond repurchase agreements to close out economic hedging positions when mortgages are sold to securitization vehicles or institutional investors.

These transactions are accounted for in a similar manner as the transactions described for securities sold short and securities purchased under resale agreements.

Mortgage and loan investments

Mortgage and loan investments are carried at their outstanding principal balances adjusted for unamortized premiums or discounts and are net of specific provisions for credit losses, if any.

Mortgage and loan investments are recognized as being impaired when the Company is no longer reasonably assured of the timely collection of the full amount of principal and interest. An allowance for loan losses is established for mortgages and loans that are known to be uncollectible. When management considers there to be no probability of collection, the investments are written off.

Mortgage and loan investments are classified as loans and receivables, except for a portfolio of long-term commercial mortgages which is designated as fair value through profit or loss and is recorded at fair value.

Intangible assets

Intangible assets are comprised of broker relationships and customer service contracts and arose in connection with the IPO in 2006. Intangible assets are subject to annual impairment review if there are events or changes in circumstances that indicate that the carrying amount may not be recoverable.

Intangible assets with finite useful lives are amortized on a straight-line basis over their estimated useful lives as follows:

Broker relationships	straight-line over 10 years
Investor servicing contracts	straight-line over 5 years

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 circumstance indicates that the asset might be impaired.

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 circumstance which indicate that the carrying amount may not be recoverable.

Purchased mortgage servicing rights

The Company purchases the rights to service mortgages from third parties. Purchased mortgage servicing rights are initially recorded at cost and charged to income over the life of the underlying mortgage servicing obligation. The fair value of such rights is determined on a periodic basis to assess the continued recoverability of the unamortized cost in relation to estimated future cash flows associated with the underlying serviced assets. Any loss arising from an excess of the unamortized cost over the fair value is immediately recorded as a charge to income.

Restricted cash

Restricted cash represents principal and interest for mortgages pledged under securitization held in trust awaiting the repayment of debt related to these mortgages.

Bank indebtedness

Bank indebtedness consists of cash balances with banks and bank indebtedness.

Cash held as collateral under securitization

Cash held as collateral under securitization is a cash-based credit enhancement held by FNFC Trust.

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 date of the consolidated statement of financial position. The income tax provision consists of current income taxes and deferred income taxes. Current and deferred taxes relating to items recognized directly in equity are recognized directly in 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/recoverable recorded in previous years.

Deferred income taxes arise on temporary differences between the carrying amounts of assets and liabilities on the consolidated statement 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 tax is 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.

Financial assets and liabilities

The Company classifies its financial assets as either financial instruments at fair value through profit or loss or loans and receivables. Financial liabilities are classified as either held at fair value through profit or loss or at amortized cost. Management determines the classification of financial assets and liabilities at initial recognition.

Financial assets and financial liabilities held at fair value through profit or loss Financial instruments are classified in this category if they are held for trading, or if they are designated by management at fair value through profit or loss at inception.

Financial instruments are classified as held for trading if they are acquired principally for the purpose of selling in the short term. Financial assets and financial liabilities may be designated at fair value through profit or loss when:

[i] the designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities or recognizing the gains and losses on them on a different basis; or

[ii] a group of financial assets and/or financial liabilities is managed and its performance evaluated on a fair value basis.

The Company has elected to measure certain of its assets at fair value through profit or loss. Most significant of these assets are: mortgages pledged under securitization and funded with ABCP-related debt, deferred placement fees receivable, certain long-term commercial mortgages within mortgage and loan investments, and certain mortgages funded with MBS debt. The mortgages funded with MBS debt were previously funded by ABCP debt and as such have retained their classification as held for trading [together with ABCP-funded mortgages, "HFT mortgages"]. For the HFT mortgages, the Company has entered into swaps to convert the mortgages from fixed rate to floating rate in order to match the mortgages with the 30-day floating rate funding provided by the ABCP notes. The swaps are derivatives and are required by IFRS to be accounted for at fair value. This value can change significantly with the passage of time as the interest rate environment changes. In order to avoid a significant accounting mismatch, the Company has measured the swapped mortgages at fair value as well so that the asset and related liability values will move inversely as interest rates change. The cash flows related to deferred placement fees receivable are typically received over five- to 10-year terms. These cash flows are subject to prepayment volatility as the mortgages underlying the deferred placement fees receivable can experience unscheduled prepayments. As well, the bank syndicate bases a portion of its loans to the Company on the carrying value of these assets. Accordingly, the Company must manage these assets on a fair value basis. The long-term commercial mortgage investments are being actively offered for sale by the Company. These mortgages are priced off of benchmark Government of Canada bonds, such that fair value is the most appropriate measurement in the circumstances.

Financial assets and financial liabilities held at fair value through profit or loss are initially recognized at fair value. Subsequent gains and losses arising from changes in fair value are recognized directly in the consolidated statement of comprehensive income and retained earnings.

Held-for-trading non-derivative financial assets can only be transferred out of the held at fair value through profit or loss category in the following circumstances: to the available-for-sale category, when, in rare circumstances, they are no longer held for the purpose of selling or repurchasing in the near term; or to the loans and receivables category, when they are no longer held for the purpose of selling or repurchasing in the near term, would have met the definition of a loan and receivable at the date of reclassification, and the Company has the intent and ability to hold the assets for the foreseeable future or until maturity.

Loans and receivables Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and it is expected that substantially all of the initial investment will be recovered, other than because of credit deterioration.

Loans and receivables are initially recognized at cost, including direct and incremental transaction costs. They are subsequently valued at amortized cost.

Held-to-maturity Held-to-maturity assets are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Company's management has the positive intention and ability to hold to maturity. These assets are initially recognized at cost, including direct and incremental transaction costs. They are subsequently valued at amortized cost using the effective interest method.

Held-to-maturity assets can be reclassified to the available-for-sale category if the portfolio becomes tainted following the sale of other than an insignificant amount of held-to-maturity assets prior to their maturity.

Derivative financial instruments

Derivatives are categorized as trading unless they are designated as hedging instruments. Derivative contracts are initially recognized at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value with the changes in fair value recognized in income as they occur. Positive values are recorded as assets and negative values are recorded as liabilities.

The Company enters into interest rate swaps to manage its interest rate exposures associated with funding fixed rate receivables with floating rate debt and to convert the fixed rate debenture into floating rate debt. These contracts are negotiated over-the-counter. Interest rate swaps require the periodic exchange of payments without the exchange of the notional principal amount on which the payments are based. The Company's policy is not to utilize derivative financial instruments for trading or speculative purposes.

Hedge accounting

At the inception of a hedging relationship, the Company documents the relationship between the hedging instruments and the hedged items, its risk management objective, its strategy for undertaking the hedge, and its assessment of whether or not the hedging instruments are highly effective in offsetting the changes attributable to the hedged risks in the hedged items.

For fair value hedges, changes in the fair value of derivatives that are designated and qualify as fair value hedging instruments are recorded in the consolidated statement of comprehensive income and retained earnings, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. The changes in fair value attributable to the hedged risk are accounted for as basis adjustment to the hedged item. If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used is amortized to the consolidated statement of comprehensive income and retained earnings over the period to maturity or derecognition.

Note 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, National Housing Act – Mortgage Backed Securities ("NHA–MBS"), and the Canada Mortgage Bonds ["CMB"] program. In these securitizations, the Company transfers the assets to special purpose entities ["SPEs"] for cash, and incurs interest-bearing obligations typically matched to the term of the mortgages. These securitizations do not qualify for derecognition, although the SPEs 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 to the Company by the SPEs 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 financings may also require cash collateral in some circumstances. As at December 31, 2011, the cash held as collateral under securitization was $56,882 [December 31, 2010 – $37,730; January 1, 2010 – $43,709].

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

	December 31, 2011	
	Carrying amount of securitized mortgages	Carrying amount of associated liabilities
NHA–MBS and CMB programs	**$ 7,560,583**	$ 7,634,173
Bank-sponsored ABCP	**2,151,556**	2,258,368
Capitalized origination costs	**49,782**	–
Debt discounts	**–**	(4,524)
	9,761,921	9,888,017
Add: principal portion of payments held in restricted cash	**225,707**	–
	$ 9,987,628	$ 9,888,017

	December 31, 2010	
	Carrying amount of securitized mortgages	Carrying amount of associated liabilities
NHA–MBS and CMB programs	$ 5,885,249	$ 6,008,854
Bank-sponsored ABCP	1,261,522	1,271,262
Capitalized origination costs	47,190	–
Debt discounts	–	(5,634)
	7,193,961	7,274,482
Add: principal portion of payments held in restricted cash	152,445	–
	$ 7,346,406	$ 7,274,482

	January 1, 2010	
	Carrying amount of securitized mortgages	Carrying amount of associated liabilities
NHA–MBS and CMB programs	$ 3,980,382	$ 3,995,080
Bank-sponsored ABCP	1,527,758	1,554,248
Capitalized origination costs	32,654	–
Debt discounts	–	(12,934)
	5,540,794	5,536,394
Add: principal portion of payments held in restricted cash	73,440	–
	$ 5,614,234	$ 5,536,394

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

Bank-sponsored ABCP mortgages are net of valuation reserves related to credit losses of $5,293 [December 31, 2010 – $5,599].

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

	2011	2010
Opening balance, January 1	**$ 47,190**	$ 32,654
Add: new origination costs in the year	**25,152**	40,185
Less: amortization in the year	**(22,560)**	(25,649)
Ending balance, December 31	**$ 49,782**	$ 47,190

During the year ended December 31, 2011, the Company advanced funds and transferred into the securitization vehicles $4,004,716 [2010 – $3,651,937] of new mortgages.

As at December 31, 2011, mortgages pledged under securitization include $9,220,847 [December 31, 2010 – $6,556,644] of insured mortgages and $496,584 [December 31, 2010 – $595,726] of uninsured mortgages.

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

2012	$ 1,102,626
2013	1,108,018
2014	1,528,490
2015	2,519,102
2016 and thereafter	3,421,514
	9,679,750
Add: capitalized origination costs	49,782
fair value premium – HFT mortgages	32,389
	9,761,921

Except for approximately $521 million of securitized mortgages included in HFT mortgages, the mortgages securitized through NHA–MBS and CMB programs have been classified as loans and receivables. These mortgages are carried at par plus adjustment for unamortized origination costs. Mortgages in bank-sponsored ABCP programs have been classified as fair value through profit or loss and are net of specific provisions for credit losses.

The following table summarizes the mortgages pledged under securitization that are past due:

Arrears days	December 31 2011	December 31 2010
31 to 60	**$ 45,801**	$ 37,696
61 to 90	**6,465**	7,292
Greater than 90	**38,306**	28,706
	$ 90,572	$ 73,694

Interest revenue-securitized mortgages consists of $43,728 [2010 – $38,244] of interest revenue related to ABCP funded mortgages, which are measured at fair value, and $210,390 [2010 – $133,282] of interest revenue related to mortgages pledged under securitization and securitized mortgages included in HFT mortgages.

The Company uses various assumptions to value the HFT mortgages, which are set out in the tables below, including the rate of unscheduled prepayment. Accordingly, HFT mortgages are subject to measurement uncertainty. The effect of variations between actual experience and assumptions will be recorded in future statements of comprehensive income. Key economic weighted average assumptions and the sensitivities of the current carrying values to immediate 10% and 20% adverse changes in those assumptions are as follows:

	December 31, 2011	
	Commercial mortgages	Residential mortgages
HFT mortgages	$ 487,959	$ 2,161,550
Average life [in months] [1]	14	44
Prepayment speed assumption [annual rate]	12.7%	15.0%
Impact on fair value of 10% adverse change	$ 74	$ 649
Impact on fair value of 20% adverse change	$ 145	$ 1,280
Discount rate [annual rate]	2.3%	2.4%
Impact on fair value of 10% adverse change	$ 2,011	$ 10,867
Impact on fair value of 20% adverse change	$ 4,005	$ 21,629

	December 31, 2010	
	Commercial mortgages	Residential mortgages
HFT mortgages	$ 523,477	$ 738,045
Average life [in months] [1]	14	20
Prepayment speed assumption [annual rate]	10.9%	15.1%
Impact on fair value of 10% adverse change	$ 32	$ 191
Impact on fair value of 20% adverse change	$ 63	$ 381
Discount rate [annual rate]	2.7%	3.4%
Impact on fair value of 10% adverse change	$ 1,786	$ 3,093
Impact on fair value of 20% adverse change	$ 3,560	$ 6,160

[1] The weighted-average life of prepayable assets in periods [for example, months or years] can be calculated by multiplying the principal collections expected in each future period by the number of periods until that future period, summing those products, and dividing the sum by the initial principal balance.

These sensitivities are hypothetical and should be used with caution. As the figures indicate, changes in carrying value based on a 10% or 20% variation in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. Also, in these tables, the effect of a variation in a particular assumption on the fair value is calculated without changing any other assumption; in reality, changes in one factor may result in changes in another [for example, increases in market interest rates may result in lower prepayments], which might magnify or counteract the sensitivities.

Note 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 pay when due.

During the year ended December 31, 2011, $1,012,743 [2010 – $1,749,715] of mortgages were placed with institutional investors, which created gains on deferred placement fees of $6,663 [2010 – $13,123]. Cash receipts on deferred placement fees receivable for the year ended December 31, 2011 were $28,261 [2010 – $91,464].

The Company uses various assumptions to value the deferred placement fees receivable, which are set out in the table below, including the rate of unscheduled prepayments. Accordingly, the deferred placement fees receivable are subject to measurement uncertainty. No assumption for credit loss was used, commensurate with the credit quality of the investors. The effect of variations between actual experience and assumptions will be recorded in future statements of comprehensive income and retained earnings. Key economic weighted average assumptions and the sensitivity of the current carrying value of residual cash flows to immediate 10% and 20% adverse changes in those assumptions are as follows:

	December 31, 2011	
	Commercial mortgages	Residential mortgages
Fair value of deferred placement fees receivable	$ 44,124	$ 14,385
Average life [in months] [1]	50	20
Prepayment speed assumption [annual rate]	0.6%	15.0%
Impact on fair value of 10% adverse change	$ 26	$ 172
Impact on fair value of 20% adverse change	$ 51	$ 340
Residual cash flows discount rate [annual rate]	4.4%	4.1%
Impact on fair value of 10% adverse change	$ 427	$ 48
Impact on fair value of 20% adverse change	$ 845	$ 95

	December 31, 2010	
	Commercial mortgages	Residential mortgages
Fair value of deferred placement fees receivable	$ 51,468	$ 25,942
Average life [in months] [1]	56	30
Prepayment speed assumption [annual rate]	0.7%	15.0%
Impact on fair value of 10% adverse change	$ 52	$ 472
Impact on fair value of 20% adverse change	$ 102	$ 932
Residual cash flows discount rate [annual rate]	5.3%	4.8%
Impact on fair value of 10% adverse change	$ 775	$ 144
Impact on fair value of 20% adverse change	$ 1,531	$ 287

[1] The weighted-average life of prepayable assets in periods [for example, months or years] can be calculated by multiplying the principal collections expected in each future period by the number of periods until that future period, summing those products, and dividing the sum by the initial principal balance.

These sensitivities are hypothetical and should be used with caution. As the figures indicate, changes in carrying value based on a 10% or 20% variation in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. Also, in these tables, the effect of a variation in a particular assumption on the fair value of the retained interest is calculated without changing any other assumption; in reality, changes in one factor may result in changes in another [for example, increases in market interest rates may result in lower prepayments], which might magnify or counteract the sensitivities.

The Company estimates that the expected cash flows from the receipt of payments on the deferred placement fees receivable will be as follows:

2012	$ 23,882
2013	16,045
2014	6,639
2015	3,430
2016 and thereafter	8,513
	$ 58,509

Note 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 or mortgages funded for placement with other investors.

Mortgages originated for the Company's own securitization programs are classified as loans and receivables and are recorded at amortized cost. Mortgages funded for placement with other investors are designated as held for trading and recorded at fair value. The fair values of mortgages held for trading approximate their carrying value due to their short-term nature. The following table summarizes the components of mortgages according to their classification:

	December 31 2011	December 31 2010	January 1 2010
Mortgages accumulated for securitization	**$ 846,694**	$ 300,309	$ 374,695
Mortgages accumulated for sale	**4,244**	17,827	8,164
	$ 850,938	$ 318,136	$ 382,859

Note 6

Mortgage and Loan Investments

As at December 31, 2011, mortgage and loan investments consist primarily of commercial first and second mortgages held for various terms, the majority of which mature within one year.

Mortgage and loan investments consist of the following:

	December 31 2011	December 31 2010	January 1 2010
Mortgage loans, classified as loans and receivables	**$ 175,071**	$ 60,555	$ 45,133
Mortgage loans, designated as fair value through profit or loss	**5,801**	10,356	9,604
	$ 180,872	$ 70,911	$ 54,737

Mortgage and loan investments classified as loans and receivables are carried at outstanding principal balances adjusted for unamortized premiums or discounts and are net of specific provisions for credit losses, if any.

The following table discloses the composition of the Company's portfolio of mortgage and loan investments by geographic region as at December 31, 2011:

Province	Portfolio balance	Percentage of portfolio
Alberta	$ 2,716	1.50
British Columbia	2,265	1.25
Manitoba	16,778	9.28
New Brunswick	1,048	0.58
Newfoundland	645	0.36
Nova Scotia	23,867	13.20
Ontario	76,232	42.14
Quebec	55,289	30.57
Saskatchewan	1,031	0.57
Yukon	1,001	0.55
	$ 180,872	100.00

These balances are net of discounts of $121 [2010 – $296] and provisions for credit losses of $4,831 [2010 – $4,831]. The portfolio contains $1,001 [2010 – $523] of insured mortgages and $184,298 [2010 – $70,388] of uninsured mortgage and loan investments as at December 31, 2011.

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

Arrears days	2011	2010
31 to 60	**$ 7,470**	$ 2,122
61 to 90	**221**	1,694
Greater than 90	**7,266**	7,739
	$ 14,957	$ 11,555

Of the above total amount, the Company considers $6,121 [2010 – $5,968] as impaired, for which it has provided an allowance for potential loss of $4,831 [2010 – $4,831] as at December 31, 2011.

Due to loan-specific issues, the Company recorded credit losses of $525 for the year ended December 31, 2010. These losses were included in other operating expenses in the consolidated statement of comprehensive income and retained earnings. The Company re-assessed the credit risk of the mortgages at December 31, 2011, and concluded that no additional accrual is required for 2011.

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

	2011						2010
	2012	2013	2014	2015	2016 and thereafter	Book value	Book value
Residential	$ 3,904	$ –	$ –	$ 100	$ 1,178	$ 5,182	$ 3,039
Commercial	130,301	30,242	6,660	–	8,487	175,690	67,872
	$ 134,205	$ 30,242	$ 6,660	$ 100	$ 9,665	$ 180,872	$ 70,911

Interest income for the year was $8,643 [2010 – $8,722] and is included in mortgage investment income on the consolidated statement of comprehensive income and retained earnings.

Note 7

Other Assets

The components of other assets are as follows:

	December 31 2011	December 31 2010	January 1 2010
Property, plant and equipment, net	$ 5,811	$ 4,483	$ 5,026
Intangible assets, net	24,531	32,499	41,967
Goodwill	29,776	29,776	29,776
	$ 60,118	$ 66,758	$ 76,769

The intangible assets have a remaining amortization period of less than five years.

For the purpose of testing goodwill for impairment, the cash-generating unit is considered to be the Corporation as a whole, since the goodwill relates to the excess purchase price paid for the Corporation's business in connection with the IPO. The recoverable amount of the Corporation is calculated by reference to the Corporation'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.

Note 8

Purchased Mortgage Servicing Rights

Purchased mortgage servicing rights consist of the following components:

	2011			2010		
	Cost	Accumulated amortization	Net book value	Cost	Accumulated amortization	Net book value
Third-party commercial mortgage servicing rights	$ 3,614	$ 2,913	$ 701	$ 3,614	$ 2,620	$ 994
Commercial mortgage-backed securities primary and master servicing rights	8,705	4,635	4,070	8,705	3,933	4,772
	$ 12,319	$ 7,548	$ 4,771	$ 12,319	$ 6,553	$ 5,766

The Company did not purchase any new servicing rights during the years ended December 31, 2011 and 2010. Amortization charged to income for the year ended December 31, 2011 was $995 [2010 – $841].

Note 9

Mortgages under Administration

As at December 31, 2011, the Company had mortgages under administration of $59,598,596 [December 31, 2010 – $53,293,132], including mortgages held on the Company's consolidated statement 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, 2011, the Company administered 193,250 mortgages [December 31, 2010 – 174,483] for 92 institutional investors [December 31, 2010 – 95] with an average remaining term to maturity of 41 months [December 31, 2010 – 44 months].

Mortgages under administration are serviced as follows:

	December 31 2011	December 31 2010	January 1 2010
Institutional investors	**$ 39,562,867**	$ 36,678,521	$ 32,879,103
Mortgages accumulated for sale or securitization and mortgage and loan investments	**1,031,720**	389,047	437,596
Securitization vehicles, deferred placement investors	**4,920,105**	4,366,884	3,904,347
Mortgages pledged under securitization	**9,761,921**	7,193,961	5,540,794
CMBS conduits	**4,321,983**	4,664,719	5,031,205
	$ 59,598,596	$ 53,293,132	$ 47,793,045

The Company's exposure to credit loss is limited to mortgages under administration totaling $619,165 [December 31, 2010 – $694,781], of which $25,378 of mortgages have principal and interest payments outstanding as at December 31, 2011 [December 31, 2010 – $38,435]. The Company incurred actual credit losses, net of recoveries, of $1,854 during the year ended December 31, 2011 [2010 – $3,689]. As at December 31, 2011, the Company has $3,995 [December 31, 2010 – $6,990] of uninsured non-performing mortgages [net of provisions for credit losses] included in accounts receivable and sundry.

Note 10

Bank Indebtedness

Bank indebtedness includes a revolving line of credit of $125,000 [December 31, 2010 – $125,000] maturing in May 2014, of which $66,403 [December 31, 2010 – $23,239] was drawn at December 31, 2011 and against 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 revolving line of credit bears a variable rate of interest based on prime and bankers' acceptance rates.

The terms of the revolving line of credit include negative covenants customary for transactions of this kind. In February 2012, FNFLP and its lenders amended the financial covenants associated with the line of credit. The amendments are effective for the Corporation's fourth quarter 2011 reporting. The amendments resulted in changes to the calculation of "Distributable Cash". As a result, the Corporation is in compliance with all revised financial covenants as amended and restated as at December 31, 2011.

Note 11

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, 2011, debt related to securitized mortgages was $9,888,017 [December 31, 2010 – $7,274,482], net of unamortized discounts of $4,524 [December 31, 2010 – $5,634]. A comparison of the carrying amounts of the pledged mortgages and the related debt is summarized in note 3.

As at December 31, 2011, debt related to participation mortgages was $69,202 [December 31, 2010 – nil].

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.

Note 12

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 used an interest rate swap to manage interest rate exposure relating to variability of interest earned on a portion of mortgages accumulated for sale held on the consolidated statement of financial position. The swap agreement that the Company entered into was an interest rate swap 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 contract that do not qualify for hedge accounting as at December 31, 2011 and 2010:

	2011				
	Less than 3 years	3 to 5 years	6 to 10 years	Total notional amount	Fair value
Interest rate swap contract	**$ 369,852**	**$ 915,712**	**$ 16,112**	**$ 1,301,676**	**$ (1,009)**

	2010				
	Less than 3 years	3 to 5 years	6 to 10 years	Total notional amount	Fair value
Interest rate swap contract	$ 783,183	$ 292,255	$ –	$ 1,075,438	$ (15,263)

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 statement of financial position.

Note 13

Debenture Loan Payable

On May 7, 2010, the Fund issued $175 million of five-year term senior secured debentures with an interest rate of 5.07% maturing on May 7, 2015. Pursuant to the Conversion, the Corporation assumed all liabilities related to the debentures. The debentures are secured on a pari-passu basis with the security under the one-year revolving line of credit described in bank indebtedness on advance. The net proceeds of the issuance were loaned to FNFLP at an interest rate of 5.1025% per annum. The Company used the proceeds of the debenture loan to repay a portion of its bank indebtedness under its existing bank credit facility. On the same date, the Company entered into a swap agreement to receive a 5.07% fixed coupon and pay monthly CDOR+2.134%, effectively protecting the Company against changes in fair value due to changes in interest rates. The swap agreement has been designated as a fair value hedge and matures on the due date of the debenture loan. The Company has a full guarantee on the debentures and the costs relating to the debenture issue have been borne by the Company.

Note 14

Commitments, Guarantees and Contingencies

As at December 31, 2011, the Company has the following operating lease commitments for its office premises:

2012	$ 3,758
2013	3,398
2014	3,263
2015	3,164
2016 and after	3,969
	$ 17,552

Outstanding commitments for future advances on mortgages with terms of one to 10 years amounted to $1,814,084 as at December 31, 2011 [2010 – $2,166,166]. 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 which 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.

Note 15

Securities Transactions under Repurchase and Resale Transactions

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

Note 16

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 based on bankers' acceptance rates and mature on or before January 16, 2012. The sale is entered into concurrently with a total return swap which, with the mortgage sale, is the economic equivalent of a repurchase agreement.

Note 17

Shareholders' Equity

[a] Authorized

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

[b] Capital stock activities

	Common shares			Preferred shares		
Balance, December 31, 2010	59,967,429	$	122,671	–	$	–
Issuance of preferred shares	–		–	4,000,000		97,394
Balance, December 31, 2011	**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. Expenses of $3,519 related to the issuance have been recorded against capital stock, net of deferred income taxes recoverable of $913. The net proceeds of $96.5 million from the issuance were paid down to FNFLP as a contribution of partner capital.

Subject to declaration by the Board of Directors, holders of the Series 1 Preferred Shares are entitled to receive a cumulative quarterly fixed dividend yielding 4.65% annually for the initial period ending March 31, 2016. Thereafter, the dividend rate may be reset every five years at a rate equal to the five-year Government of Canada yield plus 2.07%, as and when approved by the Board of Directors.

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, 2016 and on March 31 every five years thereafter. 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.

Preferred shares do not have voting rights. The par value per preferred share is $25.

[d] Common shares

Pursuant to the Conversion as described in note 1, on January 1, 2011, unitholders of the Fund exchanged 12,681,113 Class A units in the Fund for common shares in the Company on a one-for-one basis. On the same date, the pre-Arrangement shareholders of FNFC exchanged their shares in FNFLP for 47,286,316 common shares of the Company.

Common shares have voting rights and do not have par value per share.

[e] Earnings per share

	2011	**2010**
Net income	**$ 70,491**	$ 89,917
Less: dividends declared on preferred shares	**(4,316)**	–
Net earnings attributable to common shareholders	**$ 66,175**	$ 89,917
Number of common shares outstanding	**59,967,429**	59,967,429
Basic earnings per common share	**$ 1.10**	$ 1.50

Note 18
Income Taxes

Prior to the Conversion on January 1, 2011, 21.15% of FNFLP's income was allocated to the Fund and was not subject to current income tax to the extent the Fund distributed its taxable income to its unitholders. Following the Conversion, 100% of FNFLP's income is allocated to the Company and is subject to current income taxes in the hands of the Company. For comparative reporting purposes, tax provisions and balances reflect those of the Company's predecessor entities, the Fund and the Corporation.

The major components of deferred tax expense (recovery) for the year ended December 31 are as follows:

	2011	2010
Relates to origination and reversal of timing differences	**$ (3,508)**	$ 4,202

The major components of current income tax expense for the year ended December 31 are as follows:

	2011	2010
Income taxes relating to the year	**$ 29,800**	$ 25,838

The effective income tax rate reported in the consolidated statements of comprehensive income and retained earnings varies from the Canadian tax rate of 28% for the year ended December 31, 2011 [2010 – 32%] for the following reasons:

	2011	2010
Company's statutory tax rate	**28.00%**	32.00%
Income before income taxes	**$ 96,783**	$ 119,957
Income tax at statutory tax rate	**27,099**	38,386
Increase (decrease) resulting from:		
Tax obligation assumed by unitholders of the Fund	**–**	(7,737)
Permanent differences	**585**	–
Differences in current and future tax rates	**(1,320)**	(694)
Other	**(72)**	85
Income tax expense	**$ 26,292**	$ 30,040

Significant components of the Company's deferred tax liabilities for the year ended December 31 are as follows:

	2011	2010
Deferred placement fees receivable	**$ 15,008**	$ 20,809
Capitalized broker fees	**12,704**	12,746
Carrying values of mortgages pledged under securitization in excess of tax values	**8,391**	5,352
Intangible assets	**6,257**	8,492
Unamortized discount on debt related to securitized mortgages	**1,156**	1,522
Cumulative eligible capital property	**(6,711)**	(7,076)
Losses on interest rate swaps	**(4,988)**	(5,133)
Loan loss reserves not deducted for tax purposes	**(2,543)**	(2,933)
Debenture issuance costs	**(162)**	–
Share issuance costs	**(840)**	(150)
Other	**2,028**	1,092
Deferred tax liabilities	**$ 30,300**	$ 34,721

The movement in significant components of the Company's deferred tax liabilities and assets for the year ended December 31, 2011 is as follows:

	As at January 1 2011	Recognized in income	Recognized in equity	As at December 31 2011
Deferred income tax liabilities				
Deferred placement fees	$ 20,809	$ (5,801)	$ –	$ 15,008
Capitalized broker fees	12,746	(42)	–	12,704
Carrying values of mortgages pledged under securitization in excess of tax values	5,352	3,039	–	8,391
Intangible assets	8,492	(2,235)	–	6,257
Unamortized discount on debt related to securitized mortgages	1,522	(366)	–	1,156
Other	1,092	936	–	2,028
Total deferred income tax liabilities	$ 50,013	$ (4,469)	$ –	$ 45,544

	As at January 1 2011	Recognized in income	Recognized in equity	As at December 31 2011
Deferred income tax assets				
Cumulative eligible capital property	$ (7,076)	$ 365	$ –	$ (6,711)
Losses on interest rate swaps	(5,133)	145	–	(4,988)
Loan loss reserves not deducted for tax purposes	(2,933)	390	–	(2,543)
Debenture issuance costs	–	(162)	–	(162)
Share issuance costs	(150)	223	(913)	(840)
Total deferred income tax assets	$ (15,292)	$ 961	$ (913)	$ (15,244)
Net deferred income tax liabilities	**$ 34,721**	**$ (3,508)**	**$ (913)**	**$ 30,300**

The calculation of taxable income of the Company is based on estimates and the interpretation of complex 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.

Note 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 arises when changes in interest rates will affect the fair value of financial instruments.

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 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 borrowers and the time the mortgage is sold to a securitization vehicle and the underlying cost of funding is fixed. 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 Company also hedges against interest rate fluctuations by offsetting the exposure of the Company's bank indebtedness and funds held in trust. Bank indebtedness, obligations related to debt and the debenture loan payable [after the effect of the interest rate swap] are all floating rate obligations indexed to 30-day CDOR; the funds held in trust earn the Company interest based on the same floating rate basis. Because both the indebtedness and funds held in trust have comparable values, with the liabilities at $745,032 [2010 – $363,003] at December 31, 2011 and the funds held in trust at $503,294 [2010 – $527,624] on the same date, the Company considers the arrangement to be a natural hedge against short-term interest rate fluctuations.

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 2011 and 2010.

	Increase in interest rate		Decrease in interest rate	
	2011	2010	**2011**	2010
100 basis point shift				
Impact on net income and shareholders' equity	**$ 450**	$ 947	**$ (449)**	$ 707
200 basis point shift				
Impact on net income and shareholders' equity	**901**	1,895	**2,751**	3,430

As at December 31, 2011, the Company administered $21,144 [2010 – $50,553] of fixed rate commercial mortgages, of which it has a direct face value interest of $5,281 [2010 – $10,903] included in mortgage and loan investments. The other interests in these mortgages are owned by an arm's-length investor and are subject to participation agreements such that this investor receives a floating rate of return on its portion of these mortgages. The Company has exposure to the risk that short-term interest rates increase, and credit losses as the Company has a first loss position. Accordingly, these mortgages are much more sensitive to changes in interest rates and credit loss than the Company's typical mortgage and loan investments.

The Company's accounts receivable and sundry, accounts payable and accrued liabilities, and purchased mortgage servicing rights are not exposed to interest rate risk.

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, 2011, 94% [December 31, 2010 – 92%] 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 statement 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 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 under 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 four banks which provides for a total of $125,000 in financing. Bank indebtedness also includes borrowings obtained through outstanding cheques and overdraft facilities.

The Company finances the majority of its mortgages with debt derived from the securitization markets, primarily NHA–MBS and ABCP. These obligations 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, mortgage servicing income and gains on deferred placement fees revenue from three Canadian financial institutions represent approximately 47% [2010 – 43%] of the Company's total revenue. During the year ended December 31, 2011, the Company placed 51% [2010 – 54%] of all mortgages it originated with the same three institutional investors.

Fair value measurement

The Company uses the following hierarchy for determining and disclosing fair value of financial instruments recorded at fair value in the consolidated statement 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] HFT mortgages and certain mortgage and loan investments
The fair value of these mortgages is determined by discounting projected cash flows using market industry pricing practices. 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. Impaired mortgages are recorded at net realizable value.

[b] Deferred placement fees receivable
The fair value of deferred placement fees receivable is determined by internal valuation models consistent with industry practice 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. Refer to note 4, "Deferred placement fees receivable" for the key assumptions used and a sensitivity analysis.

[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.

[d] Other financial assets and financial liabilities
The fair value of mortgage and loan investments classified as loans and receivables, mortgages accumulated for sale or securitization, cash held as collateral for securitization, restricted cash and bank indebtedness corresponds to the respective outstanding amounts due to their short-term maturity profiles.

The following table represents the Company's financial instruments measured at fair value on a recurring basis:

	December 31, 2011			
	Level 1	Level 2	Level 3	Total
Financial assets				
Mortgages accumulated for sale	$ –	$ 4,244	$ –	$ 4,244
HFT mortgages	–	–	2,672,163	2,672,163
Deferred placement fees receivable	–	–	58,509	58,509
Mortgage and loan investments	–	–	5,801	5,801
Interest rate swaps	–	9,689	–	9,689
Total financial assets	$ –	$ 13,933	$ 2,736,473	$ 2,750,406
Financial liabilities				
Securities sold under repurchase agreements and sold short	$ 659,299	$ –	$ –	$ 659,299
Interest rate swaps	–	10,698	–	10,698
Total financial liabilities	$ 659,299	$ 10,698	$ –	$ 669,997

	December 31, 2010			
	Level 1	Level 2	Level 3	Total
Financial assets				
Mortgages accumulated for sale	$ –	$ 17,827	$ –	$ 17,827
HFT mortgages	–	–	1,261,522	1,261,522 [1]
Deferred placement fees receivable	–	–	77,410	77,410
Mortgage and loan investments	–	–	10,356	10,356
Interest rate swaps	–	3,849	–	3,849
Total financial assets	$ –	$ 21,676	$ 1,349,288	$ 1,370,964
Financial liabilities				
Securities sold under repurchase agreements and sold short	$ 424,673	$ –	$ –	$ 424,673
Interest rate swaps	–	19,112	–	19,112
Total financial liabilities	$ 424,673	$ 19,112	$ –	$ 443,785

The following adjustments have been made to restate the December 31, 2010 comparatives under IFRS:
[1] Under IFRS, mortgages funded with bank-sponsored ABCP programs do not meet the derecognition criteria; the Company has chosen to classify these as fair value through profit or loss and recorded at fair value. Cash held as collateral under securitization related to these mortgages is held at cost.

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, 2011 that was estimated using a valuation technique based on assumptions that are not fully supported by observable market prices or rates was a gain of approximately $3,846 [2010 – $6,698]. Although the Company's management believes that the estimated fair values are appropriate as at the date of the consolidated statement of financial position, those fair values may differ if other reasonably possible alternative assumptions are used.

The following table presents changes in the fair values [including realized losses of $16,824 [2010 – gains of $582]] of the Company's financial assets and financial liabilities for the years ended December 31, 2011 and 2010, all of which have been classified as fair value through profit or loss:

	2011	2010
HFT mortgages	$ (5,694)	$ 2,978
Deferred placement fees receivable	1,150	931
Mortgage and loan investments	1,066	3,229
Securities owned and sold short	(8,707)	27
Interest rate swaps	(792)	115
	$ (12,977)	$ 7,280

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, 2011 and 2010. 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 January 1 2011	Investments	Unrealized gain (loss) recorded in income	Payment and amortization	Fair value as at December 31 2011
Financial assets					
HFT mortgages	$ 1,261,522	$ 1,863,838	$ 1,738	$ (454,935)	**$ 2,672,163**
Deferred placement fees receivable	77,410	4,720	1,150	(24,771)	**58,509**
Mortgage and loan investments	10,356	–	1,066	(5,621)	**5,801**
Total financial assets	$ 1,349,288	$ 1,868,558	$ 3,954	$ (485,327)	**$ 2,736,473**

	Fair value as at January 1 2010	Investments	Unrealized gain (loss) recorded in income	Payment and amortization	Fair value as at December 31 2010
Financial assets					
Bank-sponsored ABCP mortgages	$ 1,558,290	$ 461,914	$ (16,875)	$ (741,807)	$ 1,261,522
Deferred placement fees receivable	90,268	9,566	931	(23,355)	77,410
Mortgage and loan investments	9,604	–	3,230	(2,478)	10,356
Total financial assets	$ 1,658,162	$ 471,480	$ (12,714)	$ (767,640)	$ 1,349,288

Derivative financial instrument and hedge accounting

The Company entered into a swap agreement to hedge the debenture loan payable against changes in fair value by converting the fixed rate debt into a variable rate debt. The swap agreement has been designated as a fair value hedge and the hedging relationship is formally documented, including the risk management objective and measurement of effectiveness. The swap agreement is recorded at fair value with the changes in fair value recognized in income. Changes in fair value attributed to the hedged risk are accounted for as basis adjustments to the debenture loan payable and are recognized in income. Accordingly, as at December 31, 2011, accounts receivable and sundry have been increased by $9,689 [December 31, 2010 – $3,849] to account for the swap derivative, and the debenture loan payable has been increased by the same amount.

Note 20

Capital Management

The Company's objective is to maintain a strong 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 equity, long-term debt and retained earnings. The Company has a minimum capital requirement as stipulated by its bank credit facility. The agreement limits the debt under bank indebtedness together with the debentures to four times FNFLP's equity. As at December 31, 2011, the ratio was 1.00:1.00 [December 31, 2010 – 0.80:1.00]. The Company was in compliance with the bank covenant throughout the year.

Note 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.

	2011		
	Residential	Commercial	Total
REVENUE			
Interest revenue – securitized mortgages	$ 172,511	$ 81,607	$ 254,118
Interest expense – securitized mortgages	(119,199)	(65,092)	(184,291)
Net interest – securitized mortgages	53,312	16,515	69,827
Placement and servicing	165,566	15,025	180,591
Mortgage investment income	13,421	15,890	29,311
	232,299	47,430	279,729
EXPENSES			
Amortization	6,203	3,621	9,824
Interest	12,989	3,009	15,998
Other operating	130,210	26,914	157,124
	149,402	33,544	182,946
Income before income taxes	$ 82,897	$ 13,886	$ 96,783
Identifiable assets	$ 9,010,099	$ 2,887,395	$ 11,897,494
Goodwill	–	–	29,776
Total assets			$ 11,927,270
Capital expenditures	$ 2,228	$ 956	$ 3,184

	2010		
	Residential	Commercial	Total
REVENUE			
Interest revenue – securitized mortgages	$ 119,986	$ 51,540	$ 171,526
Interest expense – securitized mortgages	(78,106)	(34,424)	(112,530)
Net interest – securitized mortgages	41,880	17,116	58,996
Placement and servicing	170,054	31,487	201,541
Mortgage investment income	7,971	13,221	21,192
	219,905	61,824	281,729
EXPENSES			
Amortization	7,048	4,217	11,265
Interest	11,081	2,532	13,613
Other operating	112,217	24,677	136,894
	130,346	31,426	161,772
Income before income taxes	$ 89,559	$ 30,398	$ 119,957
Identifiable assets	$ 6,656,143	$ 1,718,074	$ 8,374,217
Goodwill	–	–	29,776
Total assets			$ 8,403,993
Capital expenditures	$ 877	$ 376	$ 1,253

Note 22
Related Party Transactions

For the past three years, several of the Company's commercial borrowers applied to the Company for mezzanine mortgage financing. The amounts of the mortgages requested were in excess of the Company's internal investment policies for investments of that nature; however, a business controlled by a senior executive and shareholder of the Company entered into agreements with the borrowers to fund the mortgages. The Company serviced these mortgages during their terms at market commercial servicing rates. The mortgages, which are administered by the Company, have a balance of $33,781 as at December 31, 2011 [December 31, 2010 – $21,627].

In April 2011, the Company syndicated a $60 million mezzanine mortgage funding. As the full amount of the loan was in excess of the Company's internal investment policies, two senior executives of the Company financed $15 million each of the mortgage while the Company financed $30 million. The Company is the servicer of the mortgage during the term. As at December 31, 2011, the mortgage had a balance of $15 million, each party holding the same percentage as the original funding. The mortgage was fully repaid in January 2012.

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. During the year, the Company was engaged by the insurance company to service a portfolio of $13.6 million of mortgages at market commercial servicing rates. As at December 31, 2011, the portfolio had a balance of $13.4 million.

During the year ended December 31, 2011, the Company paid a total compensation of $2,910 [2010 – $2,882] to senior management and $216 [2010 – $195] to independent directors.

Note 23

Transition to IFRS and the Conversion

Effective January 1, 2011, the Company adopted IFRS. The Company retroactively applied IFRS to prior period financial reporting as if the transition to IFRS occurred effective January 1, 2010. Accordingly, the comparative financial results for 2010 have been presented to conform to the same accounting policies used in 2011 under IFRS. As described in note 1, the comparative financial results have also been restated pursuant to the Conversion. The presentation in these consolidated financial statements assumes that the Conversion occurred immediately prior to the transition to IFRS.

In order for users of the financial statements to better understand all of these changes, FNFLP's consolidated statement of financial position, consolidated statement of comprehensive income and retained earnings and consolidated statement of cash flows have been reconciled to the consolidated financial statements prepared under IFRS, assuming the Conversion occurred at the date of the IPO. The following reconciliations outline the impact of both IFRS and the Conversion:

[i] Reconciliation of the changes in equity as at:
- January 1, 2010
- December 31, 2010

[ii] Reconciliation of consolidated statement of comprehensive income and retained earnings for:
- Year ended December 31, 2010

[iii] Reconciliation of consolidated statement of cash flows for:
- Year ended December 31, 2010

Reconciliation of the changes in equity

The following table reconciles opening equity as at January 1, 2010 and December 31, 2010 to the comparative figures presented for FNFLP to account for the Conversion and the transition to IFRS. The largest adjustment relates to the purchase price discrepancies from the proceeds of the IPO and the subsequent Distribution Re-Investment Plan ["DRIP"] in excess of the net book value of the net assets of FNFLP. The following reconciliations provide details of the impact of the Conversion on equity at January 1, 2010 and December 31, 2010:

	Equity as at January 1 2010	Equity as at December 31 2010
Amounts as originally stated for FNFLP	$ 214,377	$ 261,360
Add: fair value of capital raised on IPO and DRIP in excess of net book value *[note [c]]*	102,122	102,122
Less: amortization of intangible assets *[note [c]]*	(30,379)	(39,847)
Less: deferred taxes related to intangible assets *[note [c]]*	(8,600)	(8,600)
Less: deferred taxes related to timing differences inherent in FNFLP's net assets *[note [c]]*	(21,919)	(26,121)
Less: adjustments related to transition to IAS 39 and consolidation of the Trust *[note [b]i and ii]*	(47,408)	(84,591)
Elimination of inter-company distributions and administration expenses *[note [c]]*	(37)	107
Add: equity related to the amalgamation of FNFC *[note [c]]*	25,726	29,746
As restated	$ 233,882	$ 234,176

Reconciliation of consolidated statement of comprehensive income for the year ended December 31, 2010

	Previous GAAP FNFLP	FNFC Trust *[note [b]i]*	MBS *[note [b]ii]*	IFRS B/S prior to Conversion	Fund/FNFC *[note [c]]*	IFRS
REVENUE						
Interest revenue – securitized mortgages	$ –	$ –	$ 171,526	$ 171,526	$ –	$ 171,526
Interest expense – securitized mortgages	–	(2,637)	(109,893)	(112,530)	–	(112,530)
Net interest – securitized mortgages	–	(2,637)	61,633	58,996	–	58,996
Placement fees	103,589	–	3,703	107,292	–	107,292
Gains on deferred placement fees	9,566	3,557	–	13,123	–	13,123
Gain on securitization	60,227	(4,514)	(55,713)	–	–	–
Mortgage investment income	26,972	(512)	(5,370)	21,090	102	21,192
Mortgage servicing income	73,846	–	–	73,846	–	73,846
Residual securities income	35,574	6,315	(41,889)	–	–	–
Realized and unrealized gains (losses) on financial instruments	33,440	2,809	(28,969)	7,280	–	7,280
	343,214	5,018	(66,605)	281,627	102	281,729
EXPENSES						
Brokerage fees	103,020	–	(32,302)	70,718	–	70,718
Salaries and benefits	44,653	–	–	44,653	–	44,653
Interest	13,808	–	(195)	13,613	–	13,613
Other operating	20,306	(2,637)	4,208	21,877	1,443	23,320
Amortization of intangible assets	–	–	–	–	9,468	9,468
	181,787	(2,637)	(28,289)	150,861	10,911	161,772
Income before income taxes	161,427	7,655	(38,316)	130,766	(10,809)	119,957
Income tax expenses – current	–	–	–	–	30,040	30,040
Net income and comprehensive income for the year	161,427	7,655	(38,316)	130,766	(40,849)	89,917
Retained earnings, beginning of year	117,087	42,966	–	160,053	(48,842)	111,211
Less distributions declared	(114,444)	–	–	(114,444)	24,821	(89,623)
Retained earnings, end of year	$ 164,070	$ 50,621	$ (38,316)	$ 176,375	$ (64,870)	$ 111,505
Earnings per share						
Basic	$ 2.69	$ 0.13	$ (0.64)	$ 2.18	$ (0.34)	$ 1.50

Reconciliation of consolidated statement of cash flows for the year ended December 31, 2010

	Previous GAAP FNFLP	MBS and other adjustments *[note [b]i and ii]*	Fund/FNFC *[note [c]]*	IFRS
OPERATING ACTIVITIES				
Net income for the year	$ 161,427	$ (30,661)	$ (40,849)	$ 89,917
Add (deduct) items not affecting cash:				
Deferred income taxes	–	–	4,202	4,202
Non-cash portion of gains on securitization and gains on deferred placement fees	(80,868)	80,868	–	–
Non-cash portion of gains on deferred placement fees	–	(9,566)	–	(9,566)
Increase in restricted cash	–	(82,758)	–	(82,758)
Net investment in mortgages pledged under securitization	–	(1,670,042)	–	(1,670,042)
Net increase in debt related to securitized mortgages	–	1,738,088	–	1,738,088
Amortization of securitization receivable and deferred placement fees receivable	81,517	(81,517)	–	–
Amortization of deferred placement fees receivable	–	23,355	–	23,355
Amortization of purchased mortgage servicing rights	841	–	–	841
Amortization of property, plant and equipment	1,796	–	–	1,796
Amortization of intangible assets	–	–	9,468	9,468
Unrealized (gains) losses on financial instruments	(32,857)	26,159	–	(6,698)
Amortization of servicing liability	(7,024)	7,024	–	–
	124,832	950	(27,179)	98,603
Net change in non-cash working capital balances related to operations	70,000	(3,736)	456	66,720
Cash provided by (used in) operating activities	$ 194,832	$ (2,786)	$ (26,723)	$ 165,323
INVESTING ACTIVITIES				
Additions to property, plant and equipment	(1,253)	–	–	(1,253)
Repayment of cash collateral and short-term notes, net	5,118	861	–	5,979
Investment in mortgage and loan investments	(74,082)	6,912	–	(67,170)
Repayment of mortgage and loan investments	60,554	(6,912)	–	53,642
Cash used in investing activities	$ (9,663)	$ 861	$ –	$ (8,802)
FINANCING ACTIVITIES				
Distributions paid	$ (92,950)	$ (4,118)	$ 7,445	$ (89,623)
Obligations related to securities and mortgages sold under repurchase agreements	(47,679)	–	–	(47,679)
Proceeds from debentures loan	175,000	–	–	175,000
Securities purchased under resale agreements and owned, net	(92,631)	–	–	(92,631)
Securities sold under repurchase agreements and sold short, net	92,274	–	–	92,274
Cash provided by financing activities	$ 34,014	$ (4,118)	$ 7,445	$ 37,341
Net decrease in bank indebtedness during the year	$ 219,183	$ (6,043)	$ (19,278)	$ 193,862
Bank indebtedness, beginning of year	(249,336)	7,147	38,431	(203,758)
Bank indebtedness, end of year	$ (30,153)	$ 1,104	$ 19,153	$ (9,896)
Supplemental cash flow information				
Interest received	$ –	$ 220,349	$ –	$ 220,349
Interest paid	14,408	102,374	–	116,782
Income taxes paid	–	–	33,387	33,387

Notes to the reconciliations:

[a] Elections under IFRS 1

The following exemptions are applicable to and have been adopted by the Company at its transition date to IFRS, which is January 1, 2010:

i. ***Estimates*** IFRS 1 requires estimates made under IFRS at the date of transition to IFRS to be consistent with estimates made for the same date under previous Canadian GAAP. The estimates previously made by the Company under Canadian GAAP were not revised for application of IFRS except where necessary to reflect any differences in accounting policies between Canadian GAAP and IFRS.

ii. ***Designation of previously recognized financial instruments*** Financial instrument designations are made on initial recognition. IFRS 1 permits an "available for sale" designation or a "fair value through profit or loss" designation to be made at the date of transition to IFRS. The Company has elected to designate mortgages pledged under securitization in NHA–MBS and CMB programs as loans and receivables, and for mortgages pledged under securitization in bank-sponsored ABCP programs as fair value through profit or loss.

iii. ***Derecognition of financial assets and financial liabilities*** This exemption allows IFRS first-time adopters to apply the IAS 39 derecognition requirements prospectively for transactions occurring on or after January 1, 2004. The Company has elected to adopt this exemption for mortgages pledged under securitization. As a result, only gains on securitization recorded after 2003 which had been recognized in the past under Canadian GAAP have been reversed against opening equity. Previously reported securitization receivables and related servicing liability have been derecognized. Accordingly, both the mortgages and associated notes funding these mortgages, which were off-balance sheet under Canadian GAAP, are shown on the consolidated statement of financial position under IFRS.

[b] IFRS revenue recognition – mortgages pledged under securitization

Under previous Canadian GAAP, the Company's securitizations were considered "transfers of receivables" for accounting purposes and were treated off-balance sheet. Gains on securitization were recognized in income at such time as the Company transferred mortgages to securitization vehicles and surrendered control whereby the transferred assets had been isolated presumptively beyond the reach of the Company and its creditors. When the Company securitized mortgages, it generally retained a residual interest, presented in the balance sheets as a securitization receivable, and the obligations associated with servicing the mortgages as a servicing liability.

Under IAS 39, these securitized mortgages do not meet the derecognition criteria, and instead are accounted for as a secured financing and remain on the Company's consolidated statement of financial position. The proceeds from the securitization process are recorded as interest-bearing notes under which the mortgages act as collateral security.

i. Mortgages issued through bank-sponsored ABCP programs are managed through FNFC Trust, a single-seller conduit, which includes three siloed portfolios: small commercial loans, Alt-A mortgages and prime mortgages. These mortgages are classified as fair value through profit or loss and recorded at fair value. As well, the mark-to-market adjustment on cash held as collateral under securitization that serves as credit enhancement for these mortgages is no longer required. The impact of these adjustments is shown on the above reconciliations under the FNFC Trust column. The FNFC Trust column is a direct reflection of the reported financial statements of FNFC Trust, plus the elimination of inter-company transactions and balances when consolidating with FNFLP.

ii. For mortgages that were issued through NHA–MBS or CMB programs, the mortgages were legally sold to funding vehicles and cannot be traded at the Company's discretion; as such, the Company classifies these mortgages as loans and receivables, and records them at amortized cost. Origination fees associated with these mortgages have been capitalized and are amortized over the terms of the mortgages on an effective yield basis. The impact of these adjustments is shown in the above reconciliations under the MBS/other adjustments column.

[c] Conversion

As described in note 1, the Company went through a series of transactions on January 1, 2011 and established First National Financial Corporation ["FNFC"] as the reporting entity. In substance, these transactions represent a combination of FNFLP, FNFC and the Fund. In order for readers of the financial statements to have meaningful comparative information, the 2010 consolidated financial statements have been restated as if the combined entity reported the same way in 2010. Significant adjustments related to the consolidation of the Fund and FNFC with FNFLP are: the addition of goodwill and intangible assets from the Fund, cash, current income taxes payable and equity from FNFC, as well as the deferred tax liabilities that were previously recorded on the financial statements of the Fund and FNFC. Under the new laws enacted by the government in 2007 for taxation of "specified investment flow-through", the Fund accrued deferred tax liabilities related to the differences between the carrying values and tax base of its assets and liabilities starting in 2007. The Fund also accrued for its portion of the deferred tax liabilities for its 21.15% ownership of FNFLP. As FNFLP is now wholly controlled by the Corporation, the 2010 comparative numbers have been adjusted for the full amount of deferred tax liabilities related to FNFLP. The impact of these adjustments is shown in the above reconciliations under the Fund/FNFC column.

[d] Impact of converting to IFRS

For the Company, this has meant a significant change in its accounting policy regarding revenue recognition, particularly in accounting for securitization transactions. Under Canadian GAAP, the Company's securitizations were considered "true sales" for accounting purposes, such that the Company recorded gains on securitization when these mortgages were sold to various securitization conduits. Under current IFRS standards, these securitizations do not meet the criteria for derecognition and instead are accounted for as a secured financing. Accordingly, the Company's securitizations [through ABCP conduits, NHA–MBS and direct CMB issuance] do not qualify for sale accounting.

The Company has restated its comparative 2010 consolidated financial statements as if IFRS accounting standards had been applied for the past six years. This restatement eliminates all securitization receivables as at January 1, 2010, and puts these mortgages back on the Company's balance sheet together with securitization debt related to these transactions. The restated consolidated statements of financial position under IFRS as at December 31, 2010 have a number of significant changes. In addition to the reversal of the securitization receivable of $157 million, the consolidated statements of financial position also include these changes: [1] an increase in the amount of the Company's assets by approximately $7.3 billion of mortgages; [2] an increase of $0.2 billion in restricted cash representing principal received on these mortgages in December 2010 and held in trust until the subsequent month; [3] an increase in the Company's liabilities by an amount of $7.3 billion of debt related to securitized mortgages; and [4] a decrease in opening equity of $19.5 million.

The reconciliations of equity balances from Canadian GAAP to IFRS feature significant decreases representing the reversal of previously recorded net securitization receivables. At January 1, 2010, these decreased equity by $104.0 million [December 31, 2010 – $157.4 million]. These decreases were offset by increases resulting from the deferral of mortgage origination costs related to mortgages pledged under securitization which the Company had expensed under Canadian GAAP. These deferred costs totaled $32.7 million at January 1, 2010 [December 31, 2010 – $47.2 million].

The reconciliations of the consolidated statements of comprehensive income both show decreased gains on securitization revenue as under IFRS these transactions do not meet the derecognition tests. In their place, the Company will earn net interest margin over the term of the pledged mortgages and related debts. In both periods presented, income before income taxes has decreased as gains on securitization exceeded the net interest income for the periods.

The Company's consolidated statement of cash flows is similarly affected by the inflation of the Company's assets under IFRS. The investing in mortgages pledged under securitization and the net increase in debt related to securitized mortgages are new significant cash flows under IFRS that were not disclosed under Canadian GAAP. In prior year disclosures, these cash flows were effectively described on a net basis in operating activities related to securitization.

Note 24

Future Accounting Changes

The Company has adopted IFRS as at January 1, 2010. The following new IFRS pronouncements have been issued and, although not yet effective, may have a future impact on the Company:

IFRS 9 – Financial Instruments
As of January 1, 2013, the Company will be required to adopt this standard, which is the first phase of the IASB project to replace IAS 39, "Financial Instruments: Recognition and Measurement". IFRS 9 provides new requirements for how an entity should classify and measure financial assets and financial liabilities that are in the scope of IAS 39. Management is currently evaluating the potential impact that the adoption of IFRS 9 will have on the Company's consolidated financial statements.

IFRS 10 – Consolidated Financial Statements
As of January 1, 2013, IFRS 10 – "Consolidated Financial Statements" will replace portions of IAS 27, "Consolidated and Separate Financial Statements" and interpretation SIC – 12, "Consolidation – Special Purpose Entities". The IASB introduced a single model for consolidating subsidiaries using a control model. In particular this standard addresses the control of SPEs. There will be little impact to the Company as it currently consolidates its SPEs fully.

IFRS 11 – Joint Arrangements
As of January 1, 2013, the IASB will expand the definition of a joint venture. The Company would be required to account for joint ventures by the equity method as opposed to proportionate consolidation.

IFRS 12 – Disclosure of Interests in Other Entities
As of January 1, 2013, the Company will be required to make new disclosures on its off-balance sheet activities including those with SPEs.

IFRS 13 – Fair Value Measurements
As of January 1, 2013, the Company will be required to adopt this standard, which provides a framework for the application of fair value to those assets and liabilities qualifying or permitted to be carried at fair value. The Company believes its current measurement of fair value is appropriate and there will be little impact.

IAS 27 – Separate Financial Statements
As of January 1, 2013, this standard will only prescribe the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements, and thus will have limited impact for the Company.

IAS 28 – Investments in Associates
As of January 1, 2013, this standard has been amended to correspond to changes in IFRS 10, 11 and 12 listed above, providing guidance for investments in associates. As described above, there should be little effect on the Company.

Corporate Governance

First National's Board of Directors and management team fully acknowledge the importance of their duty to serve the long-term interests of shareholders.

Sound corporate governance is fundamental for maintaining the confidence of investors and increasing shareholder value. As such, First National is committed to the highest standards of integrity, transparency, compliance and discipline. These standards define the relationships among all of our stakeholders – Board, management and shareholders – and are the basis for building these values and nurturing a culture of accountability and responsibility across the organization.

Policies

The Board supervises and evaluates the management of the Company and oversees matters related to our strategic direction and assesses results relative to our goals and objectives. As such, the Board has adopted several policies that reflect best practices in governance and disclosure. These include a Disclosure Policy, a Code of Business Conduct, a Whistleblower Policy and an Insider Trading Policy. These policies are compliant with the corporate governance guidelines of the Canadian Securities Administrators. As a public company, First National's Board continues to update, develop and implement appropriate governance policies and practices as it sees fit.

Committees

The Board of Directors has established an Audit Committee and a Compensation, Governance and Nominating Committee to assist in the efficient functioning of the Company's corporate governance strategy.

Audit Committee

The Audit Committee's responsibilities include:

- Management of the relationship with the external auditor including the oversight and supervision of the audit of the Company's financial statements;
- Oversight and supervision of the quality and integrity of the Company's financial statements; and
- Oversight and supervision of the adequacy of the Company's internal accounting controls and procedures, as well as its financial reporting practices.

The Audit Committee consists of three independent directors, all of whom are considered financially literate for the purposes of the Canadian Securities Administrators' Multilateral Instrument 52-110 – *Audit Committees*.

Committee Members:
John Brough (Chair), Peter Copestake and Robert Mitchell

Compensation, Governance and Nominating Committee

The Compensation, Governance and Nominating Committee's responsibilities include:

- Making recommendations concerning the compensation of the Company's senior executive officers and the remuneration of the Board of Directors;
- Developing the Company's approach to corporate governance issues and compliance with applicable laws, regulations, rules, policies and orders with respect to such issues;
- Advising the Board of Directors on filling director vacancies;
- Periodically reviewing the composition and effectiveness of the directors and the contributions of individual directors, and
- Adopting and periodically reviewing and updating the Company's written Disclosure Policy.

The Compensation, Governance and Nominating Committee consists of three independent directors for the purposes of the Canadian Securities Administrators' Multilateral Instrument 58-10 – *Disclosure of Corporate Governance Practices*.

Committee Members:
Stanley Beck (Chair), Duncan Jackman and Peter Copestake

Board Members

Collectively, the Board of Directors has extensive experience in mortgage lending, real estate, strategic planning, law and finance. The Board consists of seven members, five of whom are independent.

Stephen Smith is President of the Corporation, President of First National Financial LP and co-founder of First National. Mr. Smith has been an innovator in the development and utilization of various securitization techniques to finance mortgage assets and is a regular speaker at securitization conferences. Prior to co-founding First National in 1988, Mr. Smith held various positions including Assistant Director, Corporate Planning, Hawker Siddeley Canada and Research Analyst, Canadian Pacific Limited. Mr. Smith has a Master of Science (Economics) from the London School of Economics and Political Science, a Bachelor of Science (Honours) in Electrical Engineering, Queen's University, and is a member of the Association of Professional Engineers of Ontario. He is currently the vice-chairman of Metrolinx, a director of The Dominion of Canada General Insurance Company, the Empire Life Insurance Company and is Chair of The Historica-Dominion Institute. Mr. Smith is a graduate of the Directors Education Program at the University of Toronto, Rotman School of Management.

Moray Tawse is Vice President and Secretary of the Corporation, Vice President, Mortgage Investments of First National Financial LP and co-founder of First National. In addition to directing the operations of all of First National's commercial mortgage origination activities, he is one of Canada's leading experts on commercial real estate and is often called upon to deliver keynote addresses at national real estate symposiums. Prior to co-founding First National, Mr. Tawse was Manager of Mortgages for the Guaranty Trust Company of Canada from 1983 until 1988.

Stanley Beck, Q.C. has been President of Granville Arbitrations Limited (an arbitration and mediation firm) for more than five years. He was previously a Professor of Law and Dean at Osgoode Hall Law School, Toronto. From 1985 to 1990, Mr. Beck served as Chairman of the Ontario Securities Commission. Mr. Beck acts as a consultant on securities and corporate matters. In addition, Mr. Beck is the chairman of 407 International Inc. and GMP Capital Trust and serves on the board as a director of Scotia Utility Corp. and Scotia NewGrowth Corp.

John Brough served as President of both Wittington Properties Limited (Canada) and Torwest, Inc. (United States) real estate development companies from 1998 to 2007. From 1974 until 1996 he was with Markborough Properties, Inc., where he was Senior Vice President and Chief Financial Officer from 1986 until 1996. Mr. Brough is a Director of Kinross Gold Corporation, Silver Wheaton Corp., Canadian Real Estate Investment Trust and Transglobe Apartment Real Estate Investment Trust. Mr. Brough has a Bachelor of Arts (Economics) degree from the University of Toronto, as well as a Chartered Accountant degree. Mr. Brough is a graduate of the Directors Education Program at the University of Toronto, Rotman School of Management, and a member of the Institute of Corporate Directors.

Duncan Jackman is the Chairman, President and Chief Executive Officer of E-L Financial Corporation Limited, an investment holding company and has held similar positions with E-L Financial since 2003. Mr. Jackman is the Chairman and President of Economic Investment Trust Limited and United Corporations Limited, both closed-end investment corporations, and has acted in a similar capacity with these corporations since 2001. Prior to this, Mr. Jackman held a variety of positions including portfolio manager at Cassels Blaikie and investment analyst at RBC Dominion Securities Inc. Mr. Jackman holds a Bachelor of Arts in Literature from McGill University.

Robert Mitchell has been President of Dixon Mitchell Investment Counsel Inc., a Vancouver-based investment management company since 2000. Prior to that, Mr. Mitchell was Vice President, Investments at Seaboard Life Insurance Company. Mr. Mitchell is a director and chairs the audit committee for Discovery Parks Holdings Ltd., trustee for Discovery Parks Trust. Discovery Parks Trust was established to support the high technology and research industries in British Columbia through the development of its real estate assets. Mr. Mitchell has a MBA from University of Western Ontario, a Bachelor of Commerce (Finance) from University of Calgary, and is a CFA charterholder.

Peter Copestake currently serves as a corporate director and as a consultant to business, academic and government organizations. Over the past 30 years he has held senior financial and management positions at federally regulated financial institutions and in the federal government. From 1999 to 2007 he was Senior Vice President and Treasurer of Manulife Financial Corporation. He currently serves as the Chairman Emeritus of the Association for Financial Professionals of Canada, Chair Emeritus of the Society of Canadian Treasurers, as a member of the Investment Committee of the Board of Trustees of Queen's University, as a member of the Board of Directors of the Canadian Derivatives Clearing Corporation, the Chairman of the Independent Review Committee of First Trust Portfolios Canada and member of the Board of Directors of Manulife Bank. He is also currently serving as the Executive in Residence at the Queen's University School of Business.

Shareholder Information

Corporate Address

First National Financial Corporation
100 University Avenue
North Tower, Suite 700
Toronto, Ontario M5J 1V6
Phone: 416.593.1100
Fax: 416.593.1900

Senior Executives of First National Financial LP

Stephen Smith
Co-founder, Chairman and President

Moray Tawse
Co-founder and Vice President,
Mortgage Investments

Robert Inglis
Chief Financial Officer

Scott McKenzie
Vice President, Residential Mortgages

Jason Ellis
Managing Director, Capital Markets

Jeremy Wedgbury
Managing Director,
Commercial Mortgage Origination

Lisa White
Vice President, Mortgage Administration

Susan Biggar
General Counsel

Legal Counsel

Stikeman Elliott LLP
Toronto, Ontario

Auditors

Ernst & Young LLP
Toronto, Ontario

Investor Relations Contacts

Robert Inglis
Chief Financial Officer
rob.inglis@firstnational.ca

Steve Wallace
Vice President
Barnes Communications Inc.
swallace@barnesir.com

Investor Relations Website

www.firstnational.ca

Registrar and Transfer Agent

Computershare Investor Services Inc.
Toronto, Ontario
1.800.564.6253

Exchange Listing and Symbol

TSX: FN

Annual Meeting

May 3, 2012, 10 a.m. EDT
TMX Broadcast Centre
The Gallery
The Exchange Tower
130 King Street West
Toronto, Ontario

FIRST NATIONAL

FINANCIAL CORPORATION

VANCOUVER • CALGARY • TORONTO • MONTREAL • HALIFAX