

Consolidated financial statements

First National Financial Corporation

December 31, 2016 and 2015

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, 2016 and 2015, and the consolidated statements of comprehensive income, changes in equity and cash flows for the years then ended, 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 audits 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, 2016 and 2015, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Toronto, Canada
February 28, 2017

Ernst + Young LLP

Chartered Professional Accountants
Licensed Public Accountants



First National Financial Corporation

Consolidated statements of financial position

[in thousands of Canadian dollars]

As at December 31

	2016	2015
	\$	\$
Assets		
Restricted cash <i>[note 3]</i>	685,347	497,904
Cash held as collateral for securitization <i>[note 3]</i>	22,877	29,157
Accounts receivable and sundry	91,701	73,785
Securities purchased under resale agreements and owned <i>[note 15]</i>	1,307,801	974,062
Mortgages accumulated for sale or securitization <i>[note 5]</i>	1,837,916	1,497,413
Mortgages pledged under securitization <i>[note 3]</i>	26,106,664	24,524,061
Deferred placement fees receivable <i>[note 4]</i>	43,933	38,164
Mortgage and loan investments <i>[note 6]</i>	255,230	246,011
Other assets <i>[note 7]</i>	42,996	46,175
Total assets	30,394,465	27,926,732
Liabilities and equity		
Liabilities		
Bank indebtedness <i>[note 9]</i>	628,522	582,973
Obligations related to securities and mortgages sold under repurchase agreements <i>[note 15]</i>	1,009,572	805,850
Accounts payable and accrued liabilities <i>[note 16]</i>	122,499	125,024
Securities sold under repurchase agreements and sold short <i>[note 14]</i>	1,308,483	971,606
Debt related to securitized and participation mortgages <i>[note 10]</i>	26,514,181	24,743,727
Senior unsecured notes <i>[note 12]</i>	174,556	174,420
Income taxes payable <i>[note 18]</i>	23,255	10,202
Deferred tax liabilities <i>[note 18]</i>	63,100	55,400
Total liabilities	29,844,168	27,469,202
Equity attributable to shareholders		
Common shares <i>[note 17]</i>	122,671	122,671
Preferred shares <i>[note 17]</i>	97,394	97,394
Retained earnings	302,271	204,686
	522,336	424,751
Non-controlling interests	27,961	32,779
Total equity	550,297	457,530
Total liabilities and equity	30,394,465	27,926,732

See accompanying notes

On behalf of the Board:



John Brough



Robert Mitchell

First National Financial Corporation

Consolidated statements of comprehensive income

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

Years ended December 31

	2016	2015
	\$	\$
Revenue		
Interest revenue – securitized mortgages	639,972	620,822
Interest expense – securitized mortgages	(495,681)	(488,659)
Net interest – securitized mortgages <i>[note 3]</i>	144,291	132,163
Placement fees	176,856	165,708
Gains on deferred placement fees <i>[note 4]</i>	16,332	11,051
Mortgage investment income	57,480	52,818
Mortgage servicing income	131,428	117,059
Realized and unrealized gains (losses) on financial instruments <i>[note 19]</i>	27,750	(52,143)
	554,137	426,656
Expenses		
Brokerage fees	103,719	107,045
Salaries and benefits	87,744	84,821
Interest	38,275	35,944
Other operating	47,770	45,170
Amortization of intangible assets	2,500	5,000
	280,008	277,980
Income before income taxes	274,129	148,676
Income tax expense <i>[note 18]</i>	72,300	39,245
Net income and comprehensive income for the year	201,829	109,431
Net income and comprehensive income attributable to:		
Shareholders	199,744	107,118
Non-controlling interests	2,085	2,313
	201,829	109,431
Earnings per share		
Basic <i>[note 17]</i>	3.28	1.71

See accompanying notes

First National Financial Corporation

Consolidated statements of changes in equity

[in thousands of Canadian dollars]

Years ended December 31

	Common shares	Preferred shares	Retained earnings	Non- controlling interest	Total equity
	\$	\$	\$	\$	\$
Balance as at January 1, 2016	122,671	97,394	204,686	32,779	457,530
Comprehensive income	—	—	199,744	2,085	201,829
Dividends paid or declared	—	—	(102,159)	(1,960)	(104,119)
Redemptions by non-controlling interests	—	—	—	(4,943)	(4,943)
Balance as at December 31, 2016	122,671	97,394	302,271	27,961	550,297

	Common shares	Preferred shares	Retained earnings	Non- controlling interest	Total equity
	\$	\$	\$	\$	\$
Balance as at January 1, 2015	122,671	97,394	192,669	38,547	451,281
Comprehensive income	—	—	107,118	2,313	109,431
Dividends paid or declared	—	—	(95,101)	(2,306)	(97,407)
Redemptions by non-controlling interests	—	—	—	(5,775)	(5,775)
Balance as at December 31, 2015	122,671	97,394	204,686	32,779	457,530

See accompanying notes

First National Financial Corporation

Consolidated statements of cash flows

[in thousands of Canadian dollars]

Years ended December 31

	2016	2015
	\$	\$
Operating activities		
Net income for the year	201,829	109,431
Add (deduct) items		
Deferred income tax expense	7,700	(2,000)
Non-cash portion of gains on deferred placement fees	(15,857)	(10,716)
Increase in restricted cash	(187,443)	(1,171)
Net investment in mortgages pledged under securitization	(1,587,201)	(2,168,041)
Net increase in debt related to securitized mortgages	1,785,018	2,167,386
Provision for loan loss	3,500	2,500
Amortization of deferred placement fees receivable	9,623	7,920
Amortization of purchased mortgage servicing rights	652	914
Amortization of property, plant and equipment	4,660	4,114
Amortization of intangible assets	2,500	5,000
Unrealized losses (gains) on financial instruments	(29,907)	15,067
	<u>195,074</u>	<u>130,404</u>
Net change in non-cash working capital balances related to operations	(326,084)	(116,987)
Cash provided by (used in) operating activities	<u>(131,010)</u>	<u>13,417</u>
Investing activities		
Additions to property, plant and equipment	(4,633)	(3,497)
Repayment (investment) of cash held as collateral for securitization	6,280	(10,184)
Investment in mortgage and loan investments	(236,784)	(183,272)
Repayment of mortgage and loan investments	224,065	165,149
Cash used in investing activities	<u>(11,072)</u>	<u>(31,804)</u>
Financing activities		
Dividends paid	(103,875)	(97,188)
Obligations related to securities and mortgages sold under repurchase agreements	203,722	145,490
Increase (decrease) debt related to participation mortgages	(14,564)	2,979
Securities purchased under resale agreements and owned, net	(333,739)	357,553
Securities sold under repurchase agreements and sold short, net	349,932	(357,093)
Repayment of debenture loan	—	(175,000)
Issuance of senior unsecured notes	—	174,318
Redemption by non-controlling interests	(4,943)	(5,775)
Cash provided by financing activities	<u>96,533</u>	<u>45,284</u>
Net decrease (increase) in bank indebtedness during the year	<u>(45,549)</u>	<u>26,897</u>
Bank indebtedness, beginning of year	(582,973)	(609,870)
Bank indebtedness, end of year	<u>(628,522)</u>	<u>(582,973)</u>
Supplemental cash flow information		
Interest received	770,005	743,160
Interest paid	512,991	505,500
Income taxes paid	51,548	20,504

See accompanying notes

First National Financial Corporation

Notes to consolidated financial statements

[in thousands of Canadian dollars, unless otherwise indicated]

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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 \$99 billion in mortgages under administration as at December 31, 2016, FNFLP is an originator and underwriter of mortgages and a significant participant in the mortgage broker distribution channel.

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

2. Significant accounting policies

[a] Basis of preparation

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards [“IFRS”]. The consolidated financial statements have been prepared on a historical cost basis, except for derivative financial instruments and financial assets and financial liabilities that are recorded at fair value through profit or loss [“FVTPL”] and measured at fair value. The carrying values of recognized assets and liabilities that are 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 thousand except when otherwise indicated. The consolidated financial statements were authorized for issue by the Board of Directors on February 28, 2017.

[b] Basis of consolidation

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

The Fund and the Trust were created in 2012 as special purpose vehicles to obtain exposure to a diversified portfolio of high yielding mortgages. While the Company has legal ownership of approximately 21% of the units issued by the Fund, because of its status as the sole seller of assets to the Fund and its rights as promoter, the Company determined that it has de facto control of the both the Fund and the Trust, and therefore, has consolidated the operations and net assets of the Fund and the Trust. Non-controlling interests in the Fund and the Trust are shown as a separate component of equity on the consolidated statements of financial position to distinguish them from the equity of the Company’s shareholders. The net income attributable to non-controlling interests is also separately disclosed on the consolidated statements of comprehensive income.

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December 31, 2016 and 2015

The Company did not consolidate, in its financial statements, an SPE over which the Company does not have control. The SPE is sponsored by a third-party financial institution and acquires assets from various sellers including mortgages from the Company. The Company earns interest income from the retained interest related to these mortgages. As at December 31, 2016, the Company recorded, on its consolidated statements of financial position, its portion of the assets of the SPE amounting to \$243 million [2015 – \$165 million]. The Company also recorded, in its consolidated statements of comprehensive income, interest revenue – securitized mortgages of \$4.6 million [2015 – \$6.4 million] and interest expense – securitized mortgages of \$3.5 million [2015 – \$5.0 million] related to its interest in the SPE.

The consolidated financial statements have been prepared using consistent accounting policies for like transactions and other events in similar circumstances. All intercompany balances and revenue and expenses have been eliminated on consolidation.

[c] Use of estimates

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

[d] Significant accounting policies

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 statements of financial position, unless:

- [i] substantially all of the risks and rewards associated with the financial instruments have been transferred, in which case the assets are derecognized in full; or
- [ii] a significant portion, but not all, of the risks and rewards have been transferred. The asset is derecognized entirely if the transferee has the ability to sell the financial asset; otherwise the asset continues to be recognized to the extent of the Company's continuing involvement.

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

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

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

Derecognition

A financial asset is derecognized when:

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

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

Mortgage servicing income

The Company services substantially all of the mortgages that it originates whether the mortgage is placed with an institutional investor or transferred to a securitization vehicle. In addition, mortgages are serviced on behalf of third-party institutional investors and securitization structures. For all mortgages administered for investors or

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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. The amortization of any servicing liabilities is also recorded as mortgage servicing income.

Commencing in 2015, the Company provides underwriting and fulfillment processing services for mortgages originated by a large Canadian bank through its mortgage broker distribution channel. The Company recognizes servicing income when the services are rendered and the underwritten mortgages are funded.

Mortgage investment income

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

Brokerage fees

Brokerage fees are primarily fees paid to external mortgage brokers. Brokerage fees relating to the mortgages recorded at fair value are expensed as incurred, and those relating to mortgages recorded at amortized cost are deferred and amortized over the term of the mortgages.

Financial assets and financial liabilities

The Company classifies its financial assets as either at FVTPL or loans and receivables. Financial liabilities are classified as either at FVTPL or at amortized cost. Management determines the classification of financial assets and financial liabilities at initial recognition.

Financial assets and financial liabilities at FVTPL

Financial instruments are classified in this category if they are held for trading or if they are designated by management as FVTPL at inception.

Financial instruments are classified as FVTPL if they are acquired principally for the purpose of selling in the short term. Financial assets and financial liabilities may be designated at FVTPL 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.

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The Company has elected to measure certain of its assets at FVTPL. The most significant of these assets include a portion of mortgages pledged under securitization and funded with ABCP related debt, certain mortgages funded with MBS debt, deferred placement fees receivable, and mortgages held by the Trust. The mortgages funded with MBS debt were previously funded by ABCP debt and as such have retained their classification as FVTPL [together with other mortgages measured at fair value in mortgages pledged under securitization, "FVTPL mortgages"]. For the portion of mortgages pledged under securitization and funded with ABCP related debt, 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 swap liability values will move inversely as interest rates change. The cash flows related to deferred placement fees receivable are typically received over five-to-ten-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 Company pledges these assets under its bank credit facility. Accordingly, the Company asserts that it manages these assets on a fair value basis.

Financial assets and financial liabilities at FVTPL are initially recognized at fair value. Subsequent gains (losses) arising from changes in fair value are recognized directly in realized and unrealized losses on financial instruments in the consolidated statements of comprehensive income.

Held-for-trading non-derivative financial assets can only be transferred out of the held at FVTPL category in the following circumstances: to the available-for-sale category, where, 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, where they are no longer held for the purpose of selling or repurchasing in the near term and they 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 in the case of credit deterioration.

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

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 remeasured at their fair value with the changes in fair value recognized in income as they occur. Positive values are recorded as assets in accounts receivable and sundry and negative values are recorded as liabilities in accounts payable and accrued liabilities.

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The Company enters into interest rate swaps primarily to manage its interest rate exposures associated with funding fixed-rate mortgages with 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.

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 designated as FVTPL] have been classified as loans and receivables and are measured at their amortized cost using the effective yield method. Origination costs, such as brokerage fees and bulk insurance premiums that are directly attributable to the acquisition of such assets, are deferred and amortized over the term of the mortgages on an effective yield basis. Certain mortgages [primarily those funded under bank-sponsored ABCP programs] are classified as FVTPL and recorded at fair value.

Debt related to securitized and participation mortgages

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

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

Mortgages accumulated for sale or securitization

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

Mortgages accumulated for securitization are mortgages funded pending securitization in the Company's various programs and are classified as loans and receivables. These mortgages are recorded at amortized cost.

Securities sold short and securities purchased under resale agreements

Securities sold short consist typically of the short sale of government of Canada bonds. Bonds purchased under resale agreements consist of the purchase of a bond with the commitment from the Company to resell the bond to the original seller at a specified price. The Company uses the combination of bonds sold short and bonds

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purchased under resale agreements to economically hedge its mortgage commitments and the portion of funded mortgages that it intends to securitize in subsequent periods.

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

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 classified as loans and receivables, except for mortgages held by the Trust which are measured at FVTPL. Mortgages and loan investments are classified as loans and receivable, and 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 such 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.

Intangible assets

Intangible assets consist of broker relationships which arose in connection with the Initial Public Offering ["IPO"] in 2006. Intangible assets are subject to annual impairment review if there are events or changes in circumstances that indicate 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. The broker relationships are amortized on a straight-line basis over 10 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 circumstances indicates that the asset might be impaired.

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Property, plant and equipment

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

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

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

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

Bank indebtedness

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

Cash held as collateral for securitization

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

Servicing liability

The Company places mortgages with third-party institutional clients, and retains the rights and obligations to service these mortgages. When the service related fees are paid upfront by a third party, the Company records a servicing liability for the additional future servicing cost as compared to the market rate, and a corresponding reduction of placement fees at the time of sales. The Company determines the present value of servicing liability based on the net present value of the future expected cost of servicing these mortgages. This is similar to the method the Company uses to calculate deferred placement fees. Since quoted prices are generally not available for retained interests, the Company estimates its value based on the net present value of future expected cash

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flows, calculated using management's best estimates of key assumptions related to expected prepayment rates and discount rates commensurate with the risks involved. The Company earns the related servicing fees over the term of the mortgages on an effective yield basis.

Income taxes

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

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

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

Earnings per common share

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

3. Mortgages pledged under securitization

The Company securitizes residential and commercial mortgages in order to raise debt to fund these mortgages. Most of these securitizations consist of the transfer of fixed and floating rate mortgages into securitization programs, such as ABCP, NHA-MBS, and the Canada Mortgage Bonds ["CMB"] program. In these securitizations, the Company transfers the assets to 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 securitizations may also require cash

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collateral in some circumstances. As at December 31, 2016, the cash held as collateral for securitization was \$22,877 [2015 – \$29,157].

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

	2016	
	Carrying amount of securitized mortgages	Carrying amount of associated liabilities
	\$	\$
Securitized mortgages at face value	25,946,355	26,565,848
Mark-to-market adjustment	21,369	—
Capitalized origination costs	138,940	—
Debt discounts	—	(57,765)
	26,106,664	26,508,083
Add		
Principal portion of payments held in restricted cash	636,763	—
Participation debt	—	6,098
	26,743,427	26,514,181
	2015	
	Carrying amount of securitized mortgages	Carrying amount of associated liabilities
	\$	\$
Securitized mortgages at face value	24,346,182	24,787,631
Mark-to-market adjustment	39,914	—
Capitalized origination costs	137,965	—
Debt discounts	—	(64,566)
	24,524,061	24,723,065
Add		
Principal portion of payments held in restricted cash	452,226	—
Participation debt	—	20,662
	24,976,287	24,743,727

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

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components of mortgages pledged under securitization to securitization debt, this amount is added to the carrying value of mortgages pledged under securitization in the above table.

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

	2016 \$	2015 \$
Opening balance, January 1	137,965	125,324
Add: new origination costs capitalized in the year	65,682	72,668
Less: amortization in the year	(64,707)	(60,027)
Ending balance, December 31	138,940	137,965

During the year ended December 31, 2016, the Company invested in mortgages that were transferred into the securitization vehicles with principal balances as of December 31, 2016 of \$6,406,495 [2015 – \$5,845,336].

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

	\$
2017	3,370,518
2018	3,852,259
2019	5,199,458
2020	4,686,251
2021 and thereafter	8,837,869
	<u>25,946,355</u>

Mortgages pledged under securitization have been classified as loans and receivables, except for approximately \$2.7 billion [2015 – \$3.4 billion] of mortgages measured at FVTPL. The mortgages classified as loans and receivables are carried at par plus unamortized origination costs.

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

	2016 \$	2015 \$
Arrears days		
31 to 60	51,524	46,977
61 to 90	40,508	8,480
Greater than 90	43,205	36,891
	135,237	92,348

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Within mortgages pledged under securitization, the Company's exposure to credit loss is limited to uninsured mortgages with principal balances totalling \$125,092 [2015 – \$14,864], before consideration of the value of underlying collateral. None of these mortgages had principal and interest payments in arrears as at December 31, 2016 or 2015. All such mortgages are conventional prime single-family mortgages, with an 80% or less loan to value, and verified borrower income. Accordingly, the Company considers there to be a very small risk of loss, and no provision for credit loss has been recorded related to these mortgages.

The Company uses various assumptions to value FVTPL mortgages, which are set out in the tables below, including the rate of unscheduled prepayment. Accordingly, FVTPL 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 as at December 31 are as follows:

	2016	
	Commercial mortgages	Residential mortgages
	\$	\$
FVTPL mortgages	84,777	2,578,979
Average life [in months] ^[1]	28	21
Prepayment speed assumption [annual rate]	0.1%	10.7%
Impact on fair value of 10% adverse change	—	192
Impact on fair value of 20% adverse change	—	383
Discount rate [annual rate]	2.0%	1.8%
Impact on fair value of 10% adverse change	402	7,152
Impact on fair value of 20% adverse change	799	14,262
	<hr/>	
	2015	
	Commercial mortgages	Residential mortgages
	\$	\$
FVTPL mortgages	116,878	3,344,045
Average life [in months] ^[1]	28	23
Prepayment speed assumption [annual rate]	0.3%	11.4%
Impact on fair value of 10% adverse change	—	408
Impact on fair value of 20% adverse change	—	812
Discount rate [annual rate]	1.8%	1.7%
Impact on fair value of 10% adverse change	516	9,079
Impact on fair value of 20% adverse change	1,026	18,092

^[1] The weighted-average life of prepayable assets in periods is 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.

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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.

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, 2016, \$2,213,576 [2015 – \$1,922,906] of mortgages were placed with institutional investors, which created gains on deferred placement fees of \$16,332 [2015 – \$11,051]. Cash receipts on deferred placement fees receivable for the year ended December 31, 2016 were \$11,014 [2015 – \$9,835].

The Company uses various assumptions to value the deferred placement fees receivable, which are set out in the tables below, including the rate of unscheduled prepayments. Accordingly, the deferred placement fees receivable are subject to measurement uncertainty. As at December 31, 2016, the fair value of deferred placement fees receivable is \$43,933 [2015 – \$38,164]. An assumption of no credit losses was used, commensurate with the credit quality of the investors. An assumption of no prepayment for the commercial segment was used, as borrowers cannot refinance for financial advantage without paying the Company a fee commensurate with its investment in the mortgage. 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 sensitivity of the current carrying value of residual cash flows to immediate 10% and 20% adverse changes in those assumptions are summarized as at December 31 as follows:

	2016	2015
Average life [in months] ^[1]	63	64
Residual cash flows discount rate [annual rate]	3.9%	3.5%
Impact on fair value of 10% adverse change	\$435	\$339
Impact on fair value of 20% adverse change	\$863	\$673

^[1] The weighted-average life of prepayable assets in periods is 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.

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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.

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

	\$
2017	12,159
2018	10,484
2019	8,133
2020	5,931
2021 and thereafter	12,060
	<u>48,767</u>

5. Mortgages accumulated for sale or securitization

Mortgages accumulated for sale or securitization consist of mortgages the Company has originated for its own securitization programs together with mortgages funded for placement with institutional 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 institutional investors are designated as FVTPL, and are recorded at fair value. The fair values of mortgages classified as FVTPL approximate their carrying values due to their short-term nature. The following table summarizes the components of mortgages according to their classification:

	2016 \$	2015 \$
Mortgages accumulated for securitization	1,797,321	1,483,836
Mortgages accumulated for sale	40,595	13,577
	<u>1,837,916</u>	<u>1,497,413</u>

The Company's exposure to credit loss is limited to \$345,179 [2015 – \$217,205] of principal balances of uninsured mortgages within mortgages accumulated for sale or securitization, before consideration of the value of underlying collateral. These are conventional prime single-family mortgages similar to the mortgages described in note 3. For the same rationale, the Company has not recorded any provision for credit loss related to these mortgages.

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6. Mortgage and loan investments

As at December 31, 2016, 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:

	2016 \$	2015 \$
Mortgage loans, classified as loans and receivables	213,372	198,744
Mortgage loans, designated as FVTPL	41,858	47,267
	255,230	246,011

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, 2016:

Province/Territory	Portfolio balance \$	Percentage of portfolio %
Alberta	17,654	6.92
British Columbia	15,968	6.25
Manitoba	32,216	12.62
New Brunswick	347	0.14
Newfoundland and Labrador	811	0.32
Nova Scotia	6,627	2.60
Nunavut	188	0.07
Ontario	142,981	56.02
Prince Edward Island	440	0.17
Quebec	35,731	14.00
Saskatchewan	1,503	0.59
Yukon	764	0.30
	255,230	100.00

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

	2016	2015
	\$	\$
Arrears days		
31 to 60	4,932	3,742
61 to 90	61	2,857
Greater than 90	48,172	42,394
	53,165	48,993

The portfolio contains \$12,873 [2015 – \$19,997] of insured mortgages and \$242,357 [2015 – \$226,014] of uninsured mortgage and loan investments as at December 31, 2016. Of the uninsured mortgages, approximately \$44,231 [2015 – \$49,177] have principal balance in arrears. Three of these mortgages are non-performing and have principal balances totalling \$43,286 as at December 31, 2016 [2015 – six mortgages, totalling \$42,394]. The Company has stopped accruing interest on these mortgages, and has provided allowances for potential credit losses of \$10,041 as at December 31, 2016 [2015 – \$6,541]. The Company acknowledges that there is a higher risk of credit losses on this portfolio than the other mortgage portfolios on its consolidated statements of financial position. The Company believes it has adequately provided for such losses in the allowance for potential credit loss disclosed above and considers there to be a lower risk of credit losses on the performing mortgages, such that credit losses have been recorded only on account of non-performing mortgages.

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

						2016	2015
	2017	2018	2019	2020	2021 and thereafter	Book value	Book value
	\$	\$	\$	\$	\$	\$	\$
Residential	11,271	227	—	622	18,113	30,233	20,295
Commercial	177,016	29,667	14,481	—	3,833	224,997	225,716
	188,287	29,894	14,481	622	21,946	255,230	246,011

Interest income for the year was \$15,390 [2015 – \$15,381] and is included in mortgage investment income on the consolidated statements of comprehensive income.

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7. Other assets

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

	2016 \$	2015 \$
Property, plant and equipment, net	12,556	12,583
Intangible assets, net	—	2,500
Goodwill	29,776	29,776
Purchased mortgage servicing rights	664	1,316
	42,996	46,175

The intangible assets were fully amortized during the 2016 year.

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.

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8. Mortgages under administration

As at December 31, 2016, the Company had mortgages under administration of \$99,391,490 [2015 – \$93,829,629], including mortgages held on the Company's consolidated statements of financial position. Mortgages under administration are serviced for financial institutions such as banks, insurance companies, pension funds, mutual funds, trust companies, credit unions and securitization vehicles. As at December 31, 2016, the Company administered 303,389 mortgages [2015 – 292,905] for 102 institutional investors [2015 – 94] with an average remaining term to maturity of 41 months [2015 – 42 months].

Mortgages under administration are serviced as follows:

	2016 \$	2015 \$
Institutional investors	59,062,554	55,632,571
Mortgages accumulated for sale or securitization and mortgage and loan investments	2,099,598	1,738,652
Deferred placement investors	10,417,963	9,367,126
Mortgages pledged under securitization	25,946,355	24,346,182
CMBS conduits	1,865,020	2,745,098
	99,391,490	93,829,629

The Company's exposure to credit loss is limited to mortgage and loan investments as described in note 6, securitized mortgages as described in note 3 and uninsured mortgages held in mortgages accumulated for securitization as described in note 5. As at December 31, 2016, the Company has included in accounts receivable and sundry \$14,618 [2015 – \$19,776] of uninsured non-performing mortgages [net of provisions for credit losses] and outstanding claims from mortgage default insurers. The Company incurred actual credit losses, net of recoveries, of \$1 during the year ended December 31, 2016 [2015 – \$53].

The Company maintains trust accounts on behalf of the investors it represents. The Company also holds municipal tax funds in escrow for mortgagors. Since the Company does not hold a beneficial interest in these funds, they are not presented on the consolidated statements of financial position. The aggregate of these accounts as at December 31, 2016 was \$798,876 [2015 – \$651,737].

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9. Bank indebtedness

Bank indebtedness includes a revolving credit facility of \$1,000,000 [2015 – \$1,000,000] maturing in May 2020, of which \$624,904 [2015 – \$592,908] was drawn as at December 31, 2016 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 credit facility bears a variable rate of interest based on prime and bankers' acceptance rates.

10. Debt related to securitized and participation mortgages

Debt related to securitized mortgages represents the funding for mortgages pledged under the NHA-MBS, CMB and ABCP programs. As at December 31, 2016, debt related to securitized mortgages was \$26,508,083 [2015 – \$24,723,065], net of unamortized discounts of \$57,765 [2015 – \$64,566]. A comparison of the carrying amounts of the pledged mortgages and the related debt is summarized in note 3.

As at December 31, 2016, debt related to participation mortgages was \$6,098 [2015 – \$20,662].

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

11. Swap contracts

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

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The following tables present, by remaining term to maturity, the notional amounts and fair values of the swap contracts that do not qualify for hedge accounting as at December 31, 2016 and 2015:

	2016				Fair value \$
	Less than 3 years \$	3 to 5 years \$	6 to 10 years \$	Total notional amount \$	
Interest rate swap contracts	1,115,136	3,009,611	2,172	4,126,919	5,353

	2015				Fair value \$
	Less than 3 years \$	3 to 5 years \$	6 to 10 years \$	Total notional amount \$	
Interest rate swap contracts	133,739	2,491,102	10,188	2,635,029	(30,244)

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

12. Senior unsecured notes

On April 9, 2015, the Company issued \$175 million of new senior unsecured notes for a five-year term maturing on April 9, 2020. The notes bear interest at 4.01% payable in equal semi-annual payments commencing October 9, 2015. The net proceeds of the issuance [\$174.3 million, net of financing fees] have been invested in FNFLP. Effectively, the Company used the proceeds from the issuance to fund the maturity of the \$175 million 5.07% debentures on May 7, 2015.

13. Commitments, guarantees and contingencies

As at December 31, 2016, the Company has the following operating lease commitments for its office premises:

	\$
2017	6,965
2018	6,234
2019	2,188
2020	1,609
2021 and thereafter	1,500
	<u>18,496</u>

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Outstanding commitments for future advances on mortgages with terms of one to 10 years amounted to \$1,172,905 as at December 31, 2016 [2015 – \$1,003,088]. The commitments generally remain open for a period of up to 90 days. These commitments have credit and interest rate risk profiles similar to those mortgages that are currently under administration. Certain of these commitments have been sold to institutional investors while others will expire before being drawn down. Accordingly, these amounts do not necessarily represent future cash requirements of the Company.

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

14. Securities transactions under repurchase and resale agreements

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

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

The Company uses repurchase agreements to fund specific mortgages included in mortgages accumulated for sale or securitization. The current contracts are with financial institutions, are based on bankers' acceptance rates and mature on or before January 31, 2017.

16. Accounts payable and accrued liabilities

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

	2016	2015
	\$	\$
Accounts payable	46,900	36,634
Accrued interest on securitization debt	40,833	39,021
Servicing liability	17,893	19,125
Swap liabilities	16,873	30,244
	<u>122,499</u>	<u>125,024</u>

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

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17. Shareholders' equity

[a] Authorized

Unlimited number of common shares

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

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

[b] Capital stock

Balance, December 31, 2016 and 2015

	2016 \$	2015 \$
59,967,429 common shares	122,671	122,671
4,000,000 preferred shares	97,394	97,394

[c] Preferred shares

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

Holders of the Class A Series 1 Preferred Shares received a cumulative quarterly fixed dividend yielding 4.65% annually for the initial period ended 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. On April 1, 2016, the Company reset the dividend rate on the Class A Series 1 shares to 2.79% for a new five year term ending March 31, 2021.

Holders of Class A Series 1 Preferred Shares have the right, at their option, to convert their shares into cumulative, floating rate Class A Preferred Shares, Series 2 ["Series 2 Preferred Shares"], subject to certain conditions, on March 31, 2021 and on March 31 every five years thereafter. 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.

On April 1, 2016, certain preferred shareholders exercised their right to convert fixed rate Series 1 shares into floating rate Series 2 shares. Subsequent to the conversion, 2,887,147 Series 1 preferred shares and 1,112,853 Series 2 preferred shares were outstanding with a total carrying value of \$97,394.

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

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[d] Earnings per share

	2016 \$	2015 \$
Net income attributable to shareholders	199,744	107,118
Less: dividends declared on preferred shares	(3,213)	(4,650)
Net earnings attributable to common shareholders	196,531	102,468
Number of common shares outstanding	59,967,429	59,967,429
Basic earnings per common share	3.28	1.71

18. Income taxes

The major components of deferred tax expense (recovery) for the years ended December 31 consists of the following:

	2016 \$	2015 \$
Related to origination and reversal of timing differences	7,700	(2,000)

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

	2016 \$	2015 \$
Income taxes relating to the prior year	—	(55)
Income taxes relating to the current year	64,600	41,300
	64,600	41,245

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The effective income tax rate reported in the consolidated statements of comprehensive income varies from the Canadian tax rate of 26.54% for the year ended December 31, 2016 [2015 – 26.44%] for the following reasons:

	2016	2015
	\$	\$
Company's statutory tax rate	26.54%	26.44%
Income before income taxes	274,129	148,676
Income tax at statutory tax rate	72,754	39,310
Increase (decrease) resulting from		
Prior year adjustments	—	(55)
Income not subject to tax	(699)	(785)
Permanent differences	277	266
Differences in current and future tax rates	(89)	467
Other	57	42
Income tax expense	72,300	39,245

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The movement in significant components of the Company's deferred tax liabilities and assets for the years ended December 31, 2016 and 2015 are as follows:

	As at January 1, 2016 \$	Recognized in income \$	As at December 31, 2016 \$
Deferred income tax liabilities			
Deferred placement fees receivable	10,136	1,524	11,660
Capitalized broker fees	36,643	1,372	38,015
Carrying values of mortgages pledged under securitization in excess of tax values	10,601	(4,930)	5,671
Intangible assets	664	(664)	—
Unamortized discount on debt related to securitized mortgages	17,149	(1,818)	15,331
Other	1,174	(585)	589
Total deferred income tax liabilities	76,367	(5,101)	71,266
Deferred income tax assets			
Cumulative eligible capital property	(5,282)	374	(4,908)
Servicing liability	(5,079)	330	(4,749)
Loan loss reserves not deducted for tax purposes	(1,264)	(2,032)	(3,296)
Gains (losses) on interest rate swaps	(9,329)	14,116	4,787
Share and debenture issuance costs	(13)	13	—
Total deferred income tax assets	(20,967)	12,801	(8,166)
Net deferred income tax liabilities	55,400	7,700	63,100

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	As at January 1, 2015	Recognized in income	As at December 31, 2015
	\$	\$	\$
Deferred income tax liabilities			
Deferred placement fees receivable	9,136	1,000	10,136
Capitalized broker fees	33,048	3,595	36,643
Carrying values of mortgages pledged under securitization in excess of tax values	11,038	(437)	10,601
Intangible assets	1,978	(1,314)	664
Unamortized discount on debt related to securitized mortgages	14,894	2,255	17,149
Other	1,536	(362)	1,174
Total deferred income tax liabilities	71,630	4,737	76,367
Deferred income tax assets			
Cumulative eligible capital property	(5,639)	357	(5,282)
Servicing liability	(2,375)	(2,704)	(5,079)
Loan loss reserves not deducted for tax purposes	(684)	(580)	(1,264)
Losses on interest rate swaps	(5,316)	(4,013)	(9,329)
Share and debenture issuance costs	(216)	203	(13)
Total deferred income tax assets	(14,230)	(6,737)	(20,967)
Net deferred income tax liabilities	57,400	(2,000)	55,400

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.

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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 synthetic bond forwards [consisting of bonds sold short and bonds purchased under resale agreements] to manage interest rate exposure between the time a mortgage rate is committed to the borrower and the time the mortgage is sold to a securitization vehicle and the underlying cost of funding is set. As interest rates change, the values of these interest rate dependent financial instruments vary inversely with the values of the mortgage contracts. As interest rates increase, a gain will be recorded on the economic hedge which will be offset by the reduced future spread on mortgages pledged under securitization as the mortgage rate committed to the borrower is fixed at the point of commitment.

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

The table below provides the financial impact that an immediate and sustained 100 basis point and 200 basis point increase and decrease in short-term interest rates would have had on the net income of the Company in 2016 and 2015.

	Decrease in interest rate ^[1]		Increase in interest rate	
	2016	2015	2016	2015
	\$	\$	\$	\$
100 basis point shift				
Impact on net income and equity attributable to shareholders	2,805	3,001	(393)	(1,308)
200 basis point shift				
Impact on net income and equity attributable to shareholders	10,948	10,649	(787)	(2,615)

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

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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, 2016, 99.5% [2015 – 99.9%] of the pledged mortgages were insured mortgages. See details in note 3. The Company's exposure is further mitigated by the relatively short period over which a mortgage is held by the Company prior to securitization.

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

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

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

Liquidity risk and capital resources

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

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

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

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Market risk

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

Customer concentration risk

Placement fees and mortgage servicing income from one Canadian financial institution represent approximately 8.3% [2015 – 13.7%] of the Company's total revenue.

Fair value measurement

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

Level 1 – quoted market price observed in active markets for identical instruments;

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

Level 3 – valuation techniques in which one or more significant inputs are unobservable.

Valuation methods and assumptions

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

[a] FVTPL mortgages in mortgages under securitization 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. Refer to note 3 "Mortgages pledged under securitization" for the key assumptions used and sensitivity analysis.

[b] Deferred placement fees receivable

The fair value of deferred placement fees receivable is determined by internal valuation models using market data inputs, where possible. The fair value is determined by discounting the expected future cash flows related to the placed mortgages at market interest rates. The expected future cash flows are estimated based on certain assumptions which are not supported by observable market data. Refer to note 4 "Deferred placement fees receivable" for the key assumptions used and sensitivity analysis.

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[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] Servicing liability

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

[e] Other financial assets and financial liabilities

The fair value of 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 correspond to the respective outstanding amounts due to their short-term maturity profiles.

Carrying value and fair value of selected financial instruments

The fair value of the financial assets and financial liabilities of the Company approximates its carrying value, except for mortgages pledged under securitization, which has a carrying value of \$26,106,664 [2015 – \$24,524,061] and a fair value of \$26,388,372 [2015 – \$24,996,681], debt related to securitized and participation mortgages, which has a carrying value of \$26,514,181 [2015 – \$24,743,727], and a fair value of \$26,681,028 [2015 – \$25,035,141,883], and senior unsecured notes, which have a carrying value of \$174,556 [December 31, 2015 – \$174,420], and a fair value of \$174,349 [December 31, 2015 – \$177,233]. These fair values are estimated using valuation techniques in which one or more significant inputs are unobservable [Level 3].

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

	2016			
	Level 1	Level 2	Level 3	Total
	\$	\$	\$	\$
Financial assets				
Mortgages accumulated for sale	—	40,595	—	40,595
FVTPL mortgages	—	—	2,663,755	2,663,755
Deferred placement fees receivable	—	—	43,933	43,933
Mortgage and loan investments	—	—	41,858	41,858
Interest rate swaps	—	22,227	—	22,227
Total financial assets	—	62,822	2,749,546	2,812,368

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	2016			
	Level 1	Level 2	Level 3	Total
	\$	\$	\$	\$
Financial liabilities				
Securities sold under repurchase agreements and sold short	—	1,308,483	—	1,308,483
Interest rate swaps	—	16,873	—	16,873
Total financial liabilities	—	1,325,356	—	1,325,356

	2015			
	Level 1	Level 2	Level 3	Total
	\$	\$	\$	\$
Financial assets				
Mortgages accumulated for sale	—	13,577	—	13,577
FVTPL mortgages	—	—	3,460,924	3,460,924
Deferred placement fees receivable	—	—	38,164	38,164
Mortgage and loan investments	—	—	47,267	47,267
Total financial assets	—	13,577	3,546,355	3,559,932

Financial liabilities				
Securities sold under repurchase agreements and sold short	—	971,606	—	971,606
Interest rate swaps	—	30,244	—	30,244
Total financial liabilities	—	1,001,850	—	1,001,850

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, 2016 that was estimated using a valuation technique based on assumptions that are not fully supported by observable market prices or rates was approximately a loss of \$5,062 [2015 – a gain of \$19,366]. Although the Company's management believes that the estimated fair values are appropriate as at the date of the consolidated statements of financial position, those fair values may differ if other reasonably possible alternative assumptions are used.

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

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The following table presents changes in the fair values, including realized losses of \$2,158 [2015 – \$37,076] of the Company's financial assets and financial liabilities for the years ended December 31, 2016 and 2015, all of which have been classified as FVTPL:

	2016 \$	2015 \$
FVTPL mortgages	(4,597)	18,642
Deferred placement fees receivable	(465)	724
Securities owned and sold short	10,897	(35,076)
Interest rate swaps	21,915	(36,433)
	<u>27,750</u>	<u>(52,143)</u>

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

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, 2016 and 2015. 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, 2016 \$	Investments \$	Unrealized loss recorded in income \$	Payment and amortization \$	Fair value as at December 31, 2016 \$
Financial assets					
FVTPL mortgages	3,460,924	4,152,890	(4,597)	(4,945,462)	2,663,755
Deferred placement fees receivable	38,164	15,857	(465)	(9,623)	43,933
Mortgage and loan investments	47,267	17,394	—	(22,803)	41,858
	<u>3,546,355</u>	<u>4,186,141</u>	<u>(5,062)</u>	<u>(4,977,888)</u>	<u>2,749,546</u>

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	Fair value as at January 1, 2015 \$	Investments \$	Unrealized gain recorded in income \$	Payment and amortization \$	Fair value as at December 31, 2015 \$
Financial assets					
FVTPL mortgages	3,983,793	2,383,054	18,642	(2,924,565)	3,460,924
Deferred placement fees receivable	34,644	10,716	724	(7,920)	38,164
Mortgage and loan investments	54,818	25,215	—	(32,766)	47,267
	<u>4,073,255</u>	<u>2,418,985</u>	<u>19,366</u>	<u>(2,965,251)</u>	<u>3,546,355</u>

20. Capital management

The Company's objective is to maintain a capital base so as to maintain investor, creditor and market confidence and sustain future development of the business. Management defines capital as the Company's equity 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 unsecured notes to four times FNFLP's equity. As at December 31, 2016, the ratio was 1.39:1 [2015 – 1.64:1]. The Company was in compliance with the bank covenant throughout the year.

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21. Earnings by business segment

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

	2016		
	Residential \$	Commercial \$	Total \$
Revenue			
Interest revenue – securitized mortgages	488,299	151,673	639,972
Interest expense – securitized mortgages	(372,890)	(122,791)	(495,681)
Net interest – securitized mortgages	115,409	28,882	144,291
Placement and servicing	262,352	62,264	324,616
Mortgage investment income	40,111	17,369	57,480
Realized and unrealized gains (losses) on financial instruments	29,267	(1,517)	27,750
	447,139	106,998	554,137
Expenses			
Amortization	5,282	1,878	7,160
Interest	31,394	6,881	38,275
Other operating	199,468	35,105	234,573
	236,144	43,864	280,008
Income before income taxes	210,995	63,134	274,129
Identifiable assets	24,718,010	5,646,679	30,364,689
Goodwill	—	—	29,776
Total assets	24,718,010	5,646,679	30,394,465
Capital expenditures	3,243	1,390	4,633

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	2015		
	Residential \$	Commercial \$	Total \$
Revenue			
Interest revenue – securitized mortgages	477,552	143,270	620,822
Interest expense – securitized mortgages	(373,030)	(115,629)	(488,659)
Net interest – securitized mortgages	104,522	27,641	132,163
Placement and servicing	244,323	49,495	293,818
Mortgage investment income	33,176	19,642	52,818
Realized and unrealized losses on financial instruments	(49,011)	(3,132)	(52,143)
	333,010	93,646	426,656
Expenses			
Amortization	6,374	2,740	9,114
Interest	30,797	5,147	35,944
Other operating	195,384	37,538	232,922
	232,555	45,425	277,980
Income before income taxes	100,455	48,221	148,676
Identifiable assets	22,276,053	5,620,903	27,896,956
Goodwill	—	—	29,776
Total assets	22,276,125	5,620,903	27,926,732
Capital expenditures	2,449	1,048	3,497

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22. Related party and other transactions

In the past ten years, the Company has originated and sold several commercial mezzanine mortgages to various entities controlled by a senior executive and shareholder of the Company. The Company services these mortgages during their terms at market commercial servicing rates. During the year, three mortgages in this portfolio were refinanced as part of an overall restructuring of the borrowers' debts. Accordingly, \$22.9 million of mortgage principal was discharged and three new mortgages totaling \$36.4 million on the properties were registered. The increased amount of the total mortgage balance represents the capitalization of outstanding accrued interest on the old mortgages. The Company does not consider this transaction to be a new related party origination but will continue to administer the mortgages in its servicing system. During the year, the Company also originated \$11,586 of new mortgages for the related parties. The mortgages, which are administered by the Company, have a balance of \$69,115 as at December 31, 2016 [2015 – \$36,624]. As at December 31, 2016, three of the mortgages are secured by real estate in which the Company is also a subordinate mortgage lender.

A senior executive and shareholder of the Company has a significant investment in a mortgage default insurance company. In the ordinary course of business, the insurance company provides insurance policies to the Company's borrowers at market rates. In addition, the insurance company has also provided the Company with portfolio insurance at market premiums. The total bulk insurance premium paid in 2016 was \$2,402 [2015 – \$2,366], net of third-party investor reimbursement. The insurance company has also engaged the Company to service a portfolio of mortgages at market commercial servicing rates. As at December 31, 2016, the portfolio had a balance of \$3,965 [2015 – \$4,101].

Management compensation

During the year ended December 31, 2016, the Company paid a total annual compensation of \$3,974 [2015 – \$3,882] to six senior managers. Senior managers are defined as those persons having authority and responsibility for planning, directing and controlling the activities of the Company.

23. Future accounting changes

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

IFRS 9 – *Financial Instruments*

In July 2014, the International Accounting Standard Board ["IASB"] issued the final version of IFRS 9 – *Financial Instruments*, replacing IAS 39 and all previous versions of IFRS 9. This final version of IFRS 9 includes a model for classification and measurement, a single, forward-looking "expected loss" impairment model and a substantially-reformed approach to hedge accounting. Under this standard, financial assets are classified and measured based on the business model in which they are held and the characteristics of their contractual cash flows. The accounting model for financial liabilities is largely unchanged from IAS 39, except for the presentation of the impact of own credit risk on financial liabilities, which will be recognized in other comprehensive income, rather than in profit and loss as under IAS 39. The new general hedge accounting principles under IFRS 9 are aimed to align hedge accounting more closely with risk management. This new standard does not fundamentally change the types of hedging relationships or the requirement to measure and recognize ineffectiveness;

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however, it is expected to provide more hedging strategies that are used for risk management to qualify for hedge accounting and introduce more judgment to assess the effectiveness of a hedging relationship.

IFRS 9 is mandatorily effective for annual periods beginning on or after January 1, 2018. The Company is in the process of evaluating the impact of IFRS 9 on the Company's consolidated financial statements.

IFRS 15 – *Revenue from Contracts with Customers*

In May 2014, the IASB issued IFRS 15 – *Revenue from Contracts with Customers*, replacing IAS 11 – *Construction Contracts*, IAS 18 – *Revenue*, IFRIC 13 – *Customer Loyalty Programs*, IFRIC 15 – *Agreements for the Construction of Real Estate*, IFRIC 18 – *Transfer of Assets from Customers*, and SIC 31 – *Revenue – Barter Transactions Involving Advertising Services*. The standard contains a single model that applies to contracts with customers and two approaches to recognizing revenue: at a point in time or over time. The model features a contract-based five-step revenue recognition process to determine the nature, amount, timing and uncertainty of revenue and cash flows from the contracts with customers.

IFRS 15 is effective for fiscal years beginning on or after January 1, 2018. The Company is currently analyzing the impact on the Company's consolidated financial statements.

IFRS 16 – *Leases*

In January 2016, the IASB issued IFRS 16 – *Leases*, replacing IAS 17 – *Leases*. IFRS 16 requires lessees to recognize assets and liabilities for most leases instead of previous categories of finance leases, which are reported on the balance sheet, or operating leases, which are disclosed only in the notes to the financial statements, under IAS 17. IFRS 16 is effective for annual periods beginning on or after January 1, 2019. Early adoption is permitted for companies that also adopt IFRS 15. The Company is currently assessing the impact of this standard on the Company's consolidated financial statements.

24. Comparative consolidated financial statements

The comparative audited consolidated financial statements have been restated from statements previously presented to conform to the presentation of the 2016 audited consolidated financial statements.