First National

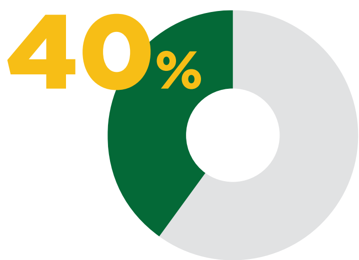
Financial Corporation

2014 Annual Report

2014
At a Glance

$85.9 Billion

Mortgages Under Administration ("MUA") grew 14% in 2014 to a record $85.9 billion. MUA has grown every year since First National placed its first mortgage in the early 1990s.

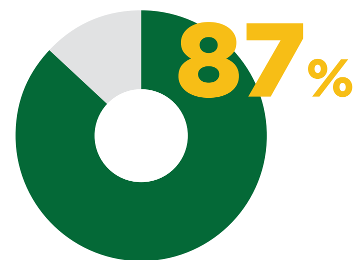


Pre-FMV[1] return on shareholders' equity of 40% in 2014 and three-year average of 46% demonstrates the Company's efficient use of capital.

[1] Pre Fair Market Return is a non-IFRS Measure, see page 8

In 2014, First National increased its common share dividend for the seventh time since its initial public offering. The Company now pays at an annualized rate per common share of $1.50.

First National paid out 87% of its earnings available to common shareholders in dividends in 2014, despite the increased investment in securitization transactions.



Stephen Smith
Chairman and Chief Executive Officer

Letter from the CEO

Fellow Shareholders:

First National produced solid financial results in 2014 while also starting a new business that will create value in future years.

Looking first at annual performance, activity levels in Canadian real estate and mortgage markets allowed the Company to set new annual records for Mortgages under Administration ($85.9 billion), mortgage originations ($16.2 billion) and revenues ($803.1 million).

Compared to 2013, these three metrics grew 14%, 15% and 3% respectively and marked the continuation of a long-term growth trend in the business that shows the results of our ongoing efforts to use our resources to deliver responsive service to mortgage brokers and borrowers. Indeed, since the business funded its first mortgage back in the early 1990s, Mortgages under Administration (MUA) have grown every year. As most of the Company's earnings come from MUA, either in the form of net interest margin or servicing income, this ongoing growth bodes well for the future.

We are particularly pleased that both segments of our business — residential and commercial — captured strong new origination volumes. First National's single family residential originations outpaced 2013 volumes by $1.6 billion or 15%, while commercial outperformed 2013 by $600 million or 18%. Although we had less business to renew in 2014 than in 2013 on the residential side, total mortgage renewals were a healthy $4.7 billion as we sustained our high rates of retention.

Annual earnings were also solid, although volatility in the bond market (which affected our interest rate hedges) and tighter mortgage spreads led to unfavourable year-over-year comparisons.

Net income was $104.5 million ($1.62 per common share) compared to $172.1 million ($2.75 per common share) in 2013; the income before taxes was $140.3 million compared to $233.5 million in 2013 and Pre-Fair Market Value EBITDA, a non-IFRS measure, was $183.1 million compared to $197.6 million in 2013. Pre-Fair Market Value EBITDA is calculated by removing gains and losses on financial instruments, which accounted for approximately three quarters of the 41% year-over-year decline in earnings per share.

Although much lower than last year, 2014 earnings provided good support for First National's common share dividend payments which, for the year, amounted to $1.48 per share, up 10 cents or 7% from 2013. The Board of Directors raised the dividend, starting with the April 2014 payment, to a $1.50 per common share annualized, or 12.5 cents per month. This marked the seventh increase since the Company's Initial Public Offering in 2006. At its current level, First National's dividend is attractive for shareholders and is sustainable for the Company — representing 87% of 2014 earnings available to common shareholders — even when factoring in our strategy of investing increasingly more cash in mortgage securitization.

Securitized mortgages are one of First National's future value creators, offering the potential for solid, long-term income. For that reason, we are pleased to note that the securitized portfolio grew to a record $22 billion dollars, up $4 billion from 2013. Securitizations completed in 2014 will produce future cash flows to enhance earnings over the next five and 10-year terms.

Underscoring Our Commitment to Mortgage Brokers and Borrowers

First National's success in 2014 and indeed over the past quarter century is not ours alone: it is shared with mortgage brokers with whom we partner on a daily basis to bring competitive mortgage choices to Canadian home owners.

Our long-term commitment to the broker channel, which now accounts for approximately $70 billion of new Canadian mortgage originations annually, and the work First National has done to remain responsive to mortgage broker needs, paid off during the year as the Company's market share in the channel increased to record levels.

We sincerely thank our mortgage broker partners for entrusting more business with First National. We pledge to continue to support the growth of the channel and to live by our high standards for application turnaround time and funding execution. We track the performance of each of our offices against these standards and it is a source of great pride for our team that First National achieved its responsiveness goals again in 2014 even with the record volumes.

Technology, in particular First National's MERLIN system, will continue to support the achievement of our service goals. When it was introduced 14 years ago, MERLIN became Canada's first online mortgage approval and tracking system and since then has continued to serve us well, providing increased transparency in underwriting for mortgage brokers. This proprietary platform will feature prominently in our future including serving as the framework for a customized technology solution for a new business venture which I will describe later in this letter.

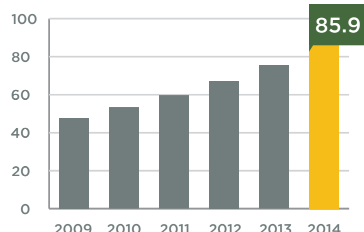
We also use technology to assist out borrowers to manage their mortgages with us. Borrowers responded positively to our efforts in 2014 on both the commercial and single family residential sides of the business. We use technology to enable responsive service. *My Mortgage*, First National's online personal mortgage management tool, was particularly well received: in 2014, it was used more than 632,000 times by over 81,635 borrowers. The online functionality to chat with our customer service representatives (a new feature added in 2014), view current mortgage balances, change payment dates, and calculate interest savings from increased payment frequencies has made *My Mortgage* an indispensable part of our service offering. Going forward, we will strive to continuously improve service to borrowers.

Keeping Funding Sources Well Diversified

The Company continued to enjoy the advantages of funding diversification. Cost-effective funding is provided by various sources including institutional partners, National Housing Act Mortgage Backed Securities, Canada Mortgage Bond dealers, asset-backed commercial paper and internal resources.

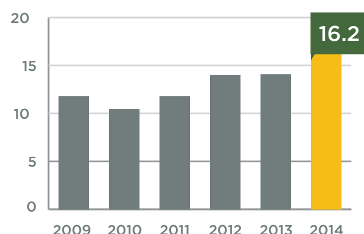
In the fourth quarter of 2014, we added another source by returning to the Commercial Mortgage Backed Securities (CMBS) market and contributing $102 million of mortgages to a CMBS pool. This is the first CMBS pool we have participated in since the global financial crisis.

Mortgages Under Administration
($ Billions)



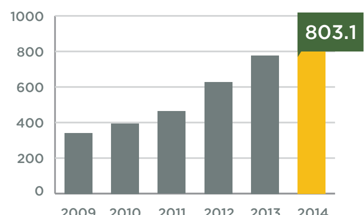
14%
Year-Over-Year Growth
2013 To 2014

Mortgage Originations
($ Billions)



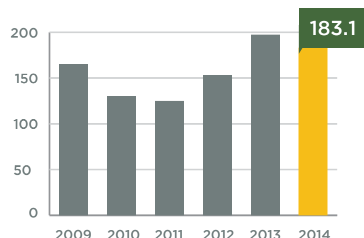
15%
Year-Over-Year Growth
2013 To 2014

Revenue
($ Millions)



3%
Year-Over-Year Growth
2013 To 2014

PRE-FMV EBITDA[1]
($ Millions)



7%
Year-Over-Year Decline
2013 To 2014

We view the potential reawakening of CMBS demand as a welcome event as it adds another dimension to First National's funding opportunities.

Building a New Business Line

One of the highlights of the year was the agreement First National entered into with one of Canada's major banks to provide underwriting and fulfillment processing services for mortgages originated by the Bank through the residential mortgage broker distribution channel. Starting in 2015, this agreement leverages the capabilities and strengths of both parties.

For First National, it provides an opportunity to showcase our operations and service-oriented technology as we accept mortgage applications and underwrite mortgages in accordance with the Bank's credit policies and compliance standards.

To ensure success, First National created and started to staff a separate division, which will operate across Canada. The division began operations in late January 2015 in Ontario with the planned roll out to Western Canada and Quebec scheduled later in the year. As is customary with new ventures, we have invested in this business in advance of realizing returns, but over time, we expect it will contribute to our earnings.

Looking Ahead

First National's financial resources, leadership in technology and dedication to service should enable the Company to respond well to opportunities in both residential and commercial markets in 2015. Looking ahead, the Company anticipates continuing strength in Canadian real estate and the continuation of its leadership position in the mortgage broker distribution channel. While the recent downturn in the price of oil may affect real estate values and demand for mortgages in Alberta and Saskatchewan this year, the national reach of First National's lending platform and the fact that we do not have significant residual credit exposure to mortgages should help us to offset the impact of this development.

[1] Pre-Fair Market Value EBITDA is a non-IFRS measure, see page 8

Overall, by realizing the significant renewal opportunities available this year and managing its partnerships with institutional customers, First National will continue to focus on sustainable profitability.

Giving Credit Where It Is Due

First National is a strong, stable business with many advantages: the most important is its workforce. Today, we employ over 770 talented, hard-working Canadians who care deeply about our customers.

We have steadily increased our talent base over the years including in 2014 when we supported the start-up of our new business venture. Bringing new talent on board and acclimatizing these professionals takes time but makes us a more resourceful and dynamic institution.

What gives First National strength, however, is the ability to retain our talent. For example, our senior leaders have been with First National for an average of over 15 years. Their business experience, connections and ongoing commitment make a significant difference for us in the marketplace.

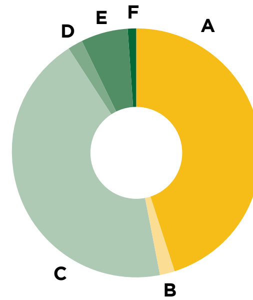
To all First National employees, new recruits and veterans alike, I offer my gratitude for your outstanding performance.

In summary, 2014 was another good year for the Company. With the ongoing support of our customers, shareholders and our Board of Directors, we look forward to realizing the full potential of First National's market leadership in the coming years.

Yours sincerely,

Stephen Smith

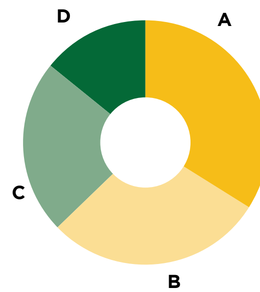
Chairman and Chief Executive Officer



Funding Sources

(for the year ended December 31, 2014)

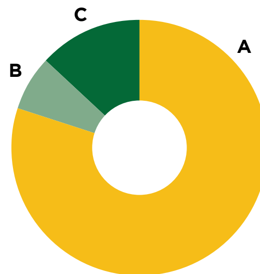
A	45%	Institutional Placements
B	2%	CMB Dealers
C	44%	NHA MBS
D	2%	Internal Resources
E	6%	ABCP
F	1%	CMBS



Revenue Sources Prior to Fair Value Gains/Losses

(for the year ended December 31, 2014)

A	34%	Institutional Placements
B	29%	Net Interest – Securitized Mortgages
C	23%	Mortgage Servicing
D	14%	Investment Income



Mortgages Under Administration

(as at December 31, 2014)

A	80%	Insured
B	7%	Multi-unit Residential and Commercial
C	13%	Conventional Single Family Residential

Our Management Team

From left to right

Rick Votano, Vice President, Information Technology
Lisa White, Vice President, Mortgage Administration
Scott McKenzie, Senior Vice President, Residential Mortgages
Stephen Smith, Co-founder, Chairman and Chief Executive Officer
Moray Tawse, Co-founder and Executive Vice President
Jeremy Wedgbury, Senior Vice President, Commercial Mortgages
Robert Inglis, Chief Financial Officer
Jason Ellis, Managing Director, Capital Markets
Hilda Wong, Vice President and General Counsel

Corporate Profile

First National Financial Corporation (TSX: FN, TSX: FN.PR.A) 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 $86 billion in mortgages under administration, First National is Canada's largest non-bank originator and underwriter of mortgages and is among the top three in market share in the mortgage broker distribution channel. For more information, please visit www.firstnational.ca.

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2014 Financial Report

Management's Discussion and Analysis

The following management's discussion and analysis ("MD&A") of financial condition and results of operations is prepared as of February 24, 2015. 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, 2014 and the notes thereto. This discussion should also be read in conjunction with the audited consolidated financial statements and notes thereto of the Company for the year ended December 31, 2014. 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 such information. The selected financial information and discussion below also refer to certain measures to assist in assessing financial performance. These measures, such as "Pre-FMV EBITDA", "Adjusted Cash Flow", and "Adjusted Cash Flow per Share", 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 measures 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 Company is available in First National Financial 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 ("FNFLP"), a Canadian-based originator, underwriter and servicer of predominantly prime residential (single-family and multi-unit) and commercial mortgages. With $86 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 mortgage broker distribution channel.

Commencing in 2013, First National has also consolidated its interest in First National Mortgage Investment Fund (the "Fund"), which it launched in late 2012. Although the Company owns about 16% of the units issued by the Fund, because of its status as sole seller to the Fund and its rights as promoter, the application of IFRS suggests that First National exercises control over the Fund. The Fund was created to obtain economic exposure to a diversified portfolio of primarily commercial mezzanine mortgages. Through the Fund's consolidation, the Company has effectively taken on a portfolio of about $55 million (December 31, 2013 - $69 million) of mortgages.

Because of the Company's small proportionate interest in the Fund's units, it has also recorded a $39 million (December 31, 2013 - $45 million) non-controlling interest in equity which offsets these assets.

2014 Results Summary

The Company is pleased with 2014 results. In the single-family segment, First National's origination was up almost 15% compared to 2013. New commercial origination increased by 18%. These volumes and consistent renewal rates enabled the Company to grow its MUA and build the value of its portfolio of securitized mortgages.

- MUA grew to $85.9 billion at December 31, 2014 from $75.6 billion at December 31, 2013, an increase of 14%; the growth from September 30, 2014, when MUA was $83.2 billion, represented an annualized increase of 13%;
- The Canadian single-family real estate market started slowly in 2014 but quickly gained momentum such that all told, 2014 was another strong year. The Company took advantage of market conditions and originated record levels of new mortgages. Single-family mortgage originations for the Company increased by 15% to $12.5 billion in 2014 from $10.9 billion in 2013. The commercial segment had a strong year as volumes increased by 18%, from $3.1 billion in 2013 to $3.7 billion in 2014. Together, overall origination increased by 15% year over year;
- The Company also took advantage of its renewal opportunities in the quarter, renewing $3.4 billion of single-family mortgages. Although retention rates were similar in each year, in 2013 the Company renewed $4.4 billion of single-family mortgages on more renewal opportunities. For the commercial segment in 2014, renewals increased to $1.3 billion from $1.2 billion in 2013;
- During 2014, the Company used the Canada Mortgage Bonds ("CMB") program to successfully securitize about $563 million of mortgages in the 10-year program and $1.1 billion of mortgages in the five-year term program. First National also securitized $263 million of mortgages for CMB replacement purposes in the year;
- Revenue for 2014 increased to $803.1 million from $776.5 million in 2013. The 3% increase is attributable to more interest revenue from the Company's growing portfolio of securitized mortgages which increased from $17.7 billion at December 31, 2013 to $22.3 billion at December 31, 2014;
- Income before income taxes for the year decreased by 40% from $233.5 million in 2013 to $140.3 million in 2014. The decrease was due, in large part, to volatility in the bond market, which negatively affected the Company's interest rate hedges. Because of the unfavourable mark to market on these hedges, large losses on financial instruments were recorded in 2014. The net change in gains and losses on financial instruments between 2014 and 2013 reduced income before income taxes between the years by $78.8 million.

- Without the impact of gains and losses on financial instruments, the Company's earnings before income taxes, depreciation and amortization ("Pre-FMV EBITDA") for 2014 decreased by 7%, from $197.6 million in 2013 to $183.1 million in 2014. This decrease is due to tighter mortgage spreads in 2014 which reduced revenue from net interest – securitized mortgages, gains on deferred placement fees and mortgage investment income.

The Company's decision to securitize more of its origination in 2014 instead of placing it with institutional investors also reduced profitability. However, by securitizing about $1.5 billion more of its origination, the Company will earn future net interest revenue as opposed to current period placement fees.

Outstanding Securities of the Corporation

At December 31, 2014 and February 24, 2015, the Corporation had 59,967,429 common shares, 4,000,000 Class A preference shares, Series 1 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	Pre-FMV EBITDA for the period[1]	Net Income per Common Share	Total Assets
2014					
Fourth Quarter	**$ 198,254**	**$ 17,856**	**$ 43,229**	**$ 0.27**	**$ 25,953,914**
Third Quarter	**$ 230,552**	**$ 35,331**	**$ 50,121**	**$ 0.56**	**$ 25,077,361**
Second Quarter	**$ 201,596**	**$ 28,217**	**$ 48,392**	**$ 0.44**	**$ 23,902,513**
First Quarter	**$ 172,705**	**$ 23,061**	**$ 41,388**	**$ 0.35**	**$ 21,683,307**
2013					
Fourth Quarter	$ 200,928	$ 41,821	$ 53,401	$ 0.66	$ 20,569,217
Third Quarter	$ 200,522	$ 39,399	$ 56,124	$ 0.63	$ 19,930,780
Second Quarter	$ 229,830	$ 67,845	$ 51,193	$ 1.10	$ 18,793,683
First Quarter	$ 145,228	$ 23,036	$ 36,864	$ 0.36	$ 17,163,697

[1] This non-IFRS measure adjusts income before income taxes by adding back expenses for amortization of intangible and capital assets but it also eliminates the impact of changes in fair value by adding back losses on the valuation of financial instruments and deducting gains on the valuation of financial instruments.

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 the gross interest earned on the mortgages pledged under securitization. Servicing revenue will change as the third-party portfolio of mortgages grows or contracts The gross interest on the mortgage portfolio is dependent both on the size of the portfolio of mortgages pledged under securitization as well as weighted average mortgage rates. All of these factors have increased over the last 24 months as the Company has steadily increased MUA and its portfolio of securitized mortgages. Net income is also dependent on conditions in the debt markets, which affect the value of gains and losses on financial instruments arising from the Company's interest rate hedging program. Accordingly, the movement of this measurement between quarters is related to factors external to the business of the Company (primarily conditions in the bond markets). By removing this volatility and analyzing Pre-FMV EBITDA, management believes a more appropriate measurement of the Company's performance can be assessed.

Generally, in the last eight quarters the Company has endeavoured to grow its origination volumes in order to build its servicing portfolio and to enable it to securitize larger amounts of mortgages in the NHA-MBS market. This longer-term strategy has been successful and Pre-FMV EBITDA grew steadily to over $197 million in 2013. Despite continued success in growing MUA and mortgage origination volume, tighter spreads in 2014 have reduced the profitability of mortgages pledged for securitization and deferred placements fees. The table above shows a trend of growing income reflecting typical Canadian seasonality: slower first and fourth quarters and stronger mid-year quarters.

Although the Company recorded growth in origination volumes and grew its MUA, the fourth quarter of 2014 featured large losses on the fair value of financial instruments as bond yields fell and negatively affected the Company's economic hedges. This decreased net income from the amount earned in the 2013 comparative quarter. Tighter spreads on deferred placement fees and pre-launch operating expenses incurred for the new underwriting business reduced pre-FMV EBITDA between the fourth quarters.

Selected Annual Financial Information for the Company's Fiscal Year

($000s, except per share amounts)

	2014	2013	2012
FOR THE YEAR ENDED DECEMBER 31			
Income Statement Highlights			
Revenue	**$ 803,107**	$ 776,508	$ 628,613
Interest expense – securitized mortgages	**(434,726)**	(323,236)	(246,736)
Brokerage fees	**(77,105)**	(84,420)	(115,978)
Salaries, interest and other operating expenses	**(143,062)**	(127,404)	(106,547)
Add (deduct): realized and unrealized (gains) losses on financial instruments	**34,916**	(43,866)	(6,153)
Pre-FMV EBITDA(1)	**183,130**	197,582	153,199
Amortization of capital assets	**(2,909)**	(2,374)	(2,059)
Amortization of intangible assets	**(5,000)**	(5,563)	(6,468)
Add (deduct): realized and unrealized gains (losses) on financial instruments	**(34,916)**	43,866	6,153
Provision for income taxes	**(35,840)**	(61,410)	(40,500)
Net Income	**104,465**	172,101	110,325
Dividends declared	**93,602**	90,294	80,859
Per Share Highlights			
Net income per common share	**1.62**	2.75	1.76
Dividends per common share	**1.48**	1.38	1.27
AT YEAR END			
Balance Sheet Highlights			
Total assets	**25,953,914**	20,569,217	15,022,236
Total long-term financial liabilities	**$ 176,418**	$ 179,195	$ 181,275

Notes:

[1] Pre-FMV EBITDA is not a recognized earnings measure under IFRS and does not have a standardized meaning prescribed by IFRS. Therefore, Pre-FMV EBITDA may not be comparable to similar measures presented by other issuers. Investors are cautioned that Pre-FMV 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.

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 most 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 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 third-party mortgage servicing contracts. Mortgage originations not only drive revenues from placement and interest from securitized mortgages, but perhaps more importantly, longer-term value from servicing fees, mortgage administration fees, renewals and the growth of the customer base for marketing initiatives. As at December 31, 2014, MUA totalled $85.9 billion, up from $75.6 billion at December 31, 2013, an increase of 14%. This compares to $83.2 billion at September 30, 2014, representing an annualized increase of about 13%.

Growth in Origination of Mortgages

The origination of mortgages not only drives the growth of MUA as described above, but leverages the Company's origination platform, which has a large fixed-cost component. As more mortgages are originated, the marginal costs of underwriting decrease. The Company can also decide to securitize more mortgages and take advantage of its origination in periods of wider mortgage spreads.

Prior to 2008, when the capital markets experienced significant turbulence, the prime mortgages that the Company originated 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. The Company elected to invest in more mortgages directly and earn the mortgage spread for itself through securitization. Mortgage spreads can be illustrated by comparing posted five-year fixed single-family mortgage rates to a similar-term Government of Canada bond as listed in the table below.

Period	Average five year Mortgage Spread for the Period
2006	1.12%
2007	1.50%
2008	2.68%
2009	1.76%
2010	1.75%
2011	1.76%
2012	1.92%
2013	1.75%
2014	1.57%

The table shows an average spread of 1.12% in 2006. With the credit crisis, this spread ballooned to as high as 3.46% in 2008. Between 2009 and 2011, liquidity issues at financial institutions diminished and the competition for mortgages increased such that spreads remained consistently higher than pre-crisis levels. In mid 2011, the United States credit rating was downgraded and interest rates fell significantly, accounting for wider mortgage spreads in 2012 which tightened again in 2013. However in 2014, more competitive pressures took mortgage rates lower and compressed mortgage spreads to 2007 levels.

Funding spreads have also narrowed in recent periods such that the spread between insured 5-year mortgages and the NHA-MBS related costs of funds is approximately 1.57%. At this level, it is still profitable for the Company to securitize. In 2014, the Company originated and renewed for securitization purposes approximately $7.6 billion of single-family mortgages and $1.3 billion of multi-unit residential mortgages in order to take advantage of these spreads. In 2014, the Company securitized through NHA-MBS approximately $1.9 billion of floating rate single-family mortgages, $4.1 billion of fixed rate single-family mortgages and $0.8 billion of fixed rate multi-unit residential mortgages.

Mortgage Underwriting and Fulfillment Processing Services

Early in the third quarter, the Company entered into an agreement with a large Canadian schedule I bank ("Bank") to provide underwriting and fulfillment processing services for mortgages originated by the Bank through the single-family residential mortgage broker channel. Under the strategic agreement, First National will employ a customized software solution based on its industry leading MERLIN technology to accept mortgage applications from the Bank in the mortgage broker channel and underwrite these mortgages in accordance with the Bank's underwriting guidelines. The Bank will fund all the mortgages underwritten under the agreement and retain full responsibility for mortgage servicing and the client relationship. The Company believes it can operate this distinct division profitably after the start up period and expects to launch the new business in Ontario in early 2015 with a full national roll out by the middle of 2015.

Management considers the agreement a way to leverage the capabilities and strengths of First National in the mortgage broker channel and add some diversity to the Company's service offerings.

Lowering Costs of Operations

Innovations in 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 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).

Increase of Bank Credit Facility
The Company uses a $1 billion revolving line of credit with a syndicate of banks. This facility enables the Company to fund the increasing amount of mortgages accumulated for securitization. The entire facility is floating rate and has a four-year term. The Company has elected to undertake this debt for a number of reasons: (1) the transaction increases the amount of debt available to fund mortgages originated for securitization purposes; (2) the debt is revolving and can be used and repaid as the Company requires, providing more flexibility than the debenture debt, which is always fully drawn; (3) the four-year term extension gives the Company a committed facility that strategically extends the maturity of this debt beyond that of the debenture in 2015; and (4) the cost of borrowing reflects the Company's BBB issuer rating.

Preferred Share Issuance
On January 25, 2011, the Company issued 4,000,000 1 Class A preference shares, Series 1 for gross proceeds of $100 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 value 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 some rights to convert into a floating rate dividend upon reset, 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. This capital has given the Company the opportunity to pursue its strategy of increased securitization, which requires upfront investment.

Employing 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 $10 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 gives the Company direct access to the CMB. Generally, the demand for high-quality fixed and floating rate investments increased significantly with the economic turmoil in 2009. This demand has

continued into 2014 and allowed the Company to issue more than $6.7 billion of mortgages through the NHA-MBS and CMB programs during the year. In August 2013, CMHC announced that it would be limiting the amount of guarantees it would issue on NHA-MBS pools created for sale to the "market". CMHC indicated that the amount of guarantees it was providing for such market pools (generally any pool not sold to the Canada Housing Trust ("CHT") for the CMB) was growing significantly. In order to better control the absolute amount of risk that it takes on in this respect, CMHC has implemented policies to allocate the amount of guarantees to issuers. The current amount being allocated to each issuer is approximately the amount that First National used in 2014. These rules are similar to the CMB allocation rules described below, which have been in place since 2008 and are subject to change each year.

Canada Mortgage Bonds Program

The CMB program is an initiative sponsored by CMHC whereby the CHT issues securities to investors in the form of semi-annual interest-yielding five- and 10-year bonds. Pursuant to the Company's approval as a seller into the CMB, the Company is 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. The Company also enjoys 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 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, and losses and gains on financial instruments ("Pre-FMV EBITDA"[1]) ; and
- Dividend payout ratio.

[1] *Pre-FMV EBITDA is not a recognized measure under IFRS. However, management believes that Pre-FMV EBITDA is a useful measure that provides investors with an indication of income normalized for capital market fluctuations and prior to capital expenditures. Pre-FMV 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 Pre-FMV EBITDA may differ from other issuers and, accordingly, Pre-FMV EBITDA may not be comparable to measures used by other issuers.*

($ 000s)	QUARTER ENDED		YEAR ENDED	
	December 31, 2014	**December 31, 2013**	**December 31, 2014**	**December 31, 2013**
FOR THE PERIOD				
Revenue	**$ 198,254**	$ 200,928	**$ 803,107**	$ 776,508
Income before income taxes	**23,206**	57,531	**140,305**	233,511
Pre-FMV EBITDA [1]	**43,229**	53,401	**183,130**	197,582
AT PERIOD END				
Total assets	**25,953,914**	20,569,217	**25,953,914**	20,569,217
Mortgages under administration	**85,889,561**	75,619,003	**85,889,561**	75,619,003

[1]This non-IFRS measure adjusts income before income taxes by adding back expenses for amortization of intangible and capital assets but it also eliminates the impact of changes in fair value by adding back losses on the valuation of financial instruments and deducting gains on the valuation of financial instruments.

Since going public in 2006, First National has been portrayed as a high-yielding dividend paying company. With a large MUA which generates continuing income and cash flow and a business model which is designed to make an efficient use of capital, the Company has been able to pay distributions to its shareholders which represent a relatively large ratio of its earnings. The Company calculates the dividend payout ratio as dividends declared on common shares over net income attributable to common shareholders. This measure is useful to shareholders as it indicates the percentage of earnings which have been paid out in dividends.

Determination of Common Share Dividend Payout Ratio

($ 000s)	QUARTER ENDED		YEAR ENDED	
	December 31, 2014	**December 31, 2013**	**December 31, 2014**	**December 31, 2013**
FOR THE PERIOD				
Net income attributable to common shareholders	**$ 17,180**	$ 41,066	**$ 101,710**	$169,726
Dividends paid or declared on common shares	**22,488**	20,988	**88,952**	82,955
Common Share Dividend Payout Ratio	**131%**	51%	**87%**	49%
After tax Pre-FMV Dividend Payout Ratio [1]	**74%**	57%	**70%**	60%

[1] This non-IFRS measure adjusts the net income used in the calculation of the dividend payout ratio to after tax Pre-FMV earnings so as to eliminate the impact of changes in fair value by adding back losses on the valuation of financial instruments and deducting gains on the valuation of financial instruments.

For the year ended December 31, 2014, the common share payout ratio was over 87%, higher than the 49% ratio calculated for 2013. A significant portion of this change is due to volatility in the bond market, which negatively affected the Company's interest rate hedges in 2014. In contrast there was a large favourable impact in the 2013 results. These gains or losses are recorded in the period in which the bond yields change; however, the offsetting economic gains or losses are not recorded in the same period. Instead, the resulting economic gain (or loss) will be reflected in wider or narrower spreads on the mortgages pledged for securitization and will be generally realized in net interest margin over the terms of the mortgages. If these amounts are excluded from the above calculations, the dividend payout ratio for 2014 would have been 70% versus 60% in 2013. For the quarter ended December 31, 2014, $18 million of such losses were incurred. Without the tax-effected losses, the fourth quarter would have had a dividend payout ratio of 74% compared to an adjusted ratio of 57% in 2013.

The Company also paid $4.65 million of dividends on its preferred shares in 2014.

Revenues and Funding Sources

Mortgage Origination

The Company derives a significant amount of its revenue from mortgage origination activities. Most mortgages originated are funded either by placement with institutional investors or through 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 provide the Company with servicing fees to complement revenue earned through originations. For the year ended December 31, 2014, new origination volume increased from $14.1 billion to $16.2 billion, or about 15%, compared to 2013.

Securitization

The Company securitizes a portion of its origination through various vehicles, including NHA-MBS, CMB and Asset-backed Commercial Paper ("ABCP"). Although legally these transactions represent sales of mortgages, for accounting purposes they do not meet the requirements for sale 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 $20.9 billion of new originations and renewals for the year ended December 31, 2014, $8.9 billion was originated for its own securitization programs.

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 a base spread are sold. Normally the Company would earn an upfront cash placement fee, but 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 $20.9 billion of new originations and renewals in 2014, $11.4 billion was placed with institutional investors.

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 borrowers' property tax escrows, reserve escrows 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 additional servicing 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, 2014	QUARTER ENDED December 31, 2013	YEAR ENDED December 31, 2014	YEAR ENDED December 31, 2013
MORTGAGE ORIGINATIONS BY SEGMENT				
New Single-family residential	**2,860**	2,496	**12,525**	10,925
New Multi-unit and commercial	**1,195**	887	**3,701**	3,133
Sub-total	**4,055**	3,383	**16,226**	14,058
Single-family residential renewals	**823**	824	**3,365**	4,404
Multi-unit and commercial renewals	**328**	392	**1,306**	1,174
Total origination and renewals	**5,206**	4,599	**20,897**	19,636
MORTGAGE ORIGINATIONS BY FUNDING SOURCE				
Institutional investors – new residential	**1,434**	1,704	**6,323**	7,131
Institutional investors – renew residential	**372**	403	**1,700**	1,621
Institutional investors – multi/commercial	**1,091**	967	**3,343**	2,952
NHA-MBS/ CMB/ ABCP securitization	**2,095**	1,428	**8,942**	7,476
CMBS	**102**	—	**102**	—
Internal Company resources	**112**	97	**487**	456
Total	**5,206**	4,599	**20,897**	19,636
MORTGAGES UNDER ADMINISTRATION				
Single-family residential	**66,992**	57,652	**66,992**	57,652
Multi-unit residential and commercial	**18,898**	17,967	**18,898**	17,967
Total	**$ 85,890**	$ 75,619	**$ 85,890**	$ 75,619

Total new mortgage origination volumes increased in 2014 compared to 2013 by 15%. Single-family volumes increased by 15% and commercial segment volumes increased by 18% year over year as demand for housing and commercial real estate continued and the Company increased its share in the mortgage broker channel. The fourth quarter of 2014 was consistent with the full year results as single-family volumes increased by 15% and commercial volume grew 35% compared to the 2013 quarter. When combined with renewals, total production increased from $19.6 billion in 2013 to almost $20.9 billion in 2014, or by 7%.

The low interest rate environment which existed for most of 2013 continued throughout 2014. Low mortgage rates, which stimulate increased real estate transactions, together with the Company's expertise in underwriting CMHC mortgages, drove higher origination volumes. Origination for direct securitization into NHA-MBS, CMB and ABCP programs remained a large part of the Company's strategy with volumes increasing from $7.5 billion in 2013 to $8.9 billion in 2014.

Net Interest - Securitized Mortgages
Comparing the year ended December 31, 2014 to the year ended December 31, 2013, "net interest – securitized mortgages" increased by 9% to $115.5 million from $106.0 million. The increase was due to a larger portfolio of securitized mortgages offset by tighter weighted-average spreads on the portfolio year over year. The portfolio of mortgages funded through securitization increased from $17.7 billion as at December 31, 2013 to $22.3 billion as at December 31, 2014; however, the market for prime mortgages became more competitive as the Company grew this portfolio. Between December 31, 2013 and December 31, 2014, tighter mortgage spreads and marginally higher origination costs decreased margins by approximately 0.11%. Generally as higher-spread securitizations have amortized down, new securitizations have been entered into at tighter spreads. Net interest is also affected by the amortization of deferred origination and other costs that are capitalized on securitized mortgages.

Placement Fees
Placement fee revenue decreased by 13% in 2014 to $127.1 million from $145.4 million in 2013. New single-family origination volume for institutional customers, excluding renewals, decreased from $7.1 billion in 2013 to $6.3 billion in 2014 or by 11%. The decrease is also a result of marginally lower per unit pricing on placement fees for both residential and commercial segment origination. The Company earned over $13.0 million of placement fees from mortgage renewals sold to institutional investors in 2014 compared to $9.4 million in 2013.

Gains on Deferred Placement Fees
Gains on deferred placement fees revenue decreased 5% in 2014 to $10.5 million from $11.0 million in 2013. The gains relate to multi-unit residential mortgages originated and sold to institutional NHA-MBS issuers. Although volumes for these transactions increased by 23% from the 2013 to 2014, spreads on these transactions tightened in 2014 so that the Company realized lower per unit gains.

Mortgage Servicing Income
Mortgage servicing income increased by less than 1% to $93.1 million from $92.8 million. This increase was due to increased securitization by the Company and lower administration fees. Although the growth in the amount of total MUA was 14% year over year, the third-party MUA only grew by 7% between 2013 and 2014. The majority of growth in MUA was for securitized mortgages. At December 31, 2014, there were approximately $23.7 billion of mortgages in MUA on which the Company earned net interest spread as opposed to servicing revenue. This has grown from $18.2 billion in 2013, or by 31%. As the securitized portfolio has grown and become a larger part of MUA, mortgage servicing income has been sacrificed for interest spread as recorded in "net interest — securitized mortgages" revenue. The Company's average rate of servicing has also dropped as volume discount thresholds for some residential investors were reached in late 2013.

Mortgage Investment Income

Mortgage investment income increased 5% to $57.1 million from $54.2 million. The change is largely due to the Company's securitization program. As the Company elects to securitize more of its origination, mortgages accumulated for securitization increase and earn the Company higher interest income in the warehousing period prior to securitization.

Realized and Unrealized Gains (Losses) on Financial Instruments

For First National, this financial statement 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 that 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, and mortgages designated as held for trading). The following table summarizes these gains and losses by category in the periods indicated:

Summary of realized and unrealized gains (losses) on financial instruments

($ 000s)	QUARTER ENDED		YEAR ENDED	
	December 31, 2014	**December 31, 2013**	**December 31, 2014**	**December 31, 2013**
Gains (losses) on short bonds used for the economic hedging program	**(16,550)**	3,945	**(41,486)**	28,688
Gains (losses) related to the mortgages designated at fair value net of interest rate swaps	**(1,620)**	1,618	**6,337**	15,141
Gains (losses) on deferred placement fees receivable	**226**	65	**307**	(297)
Other gains	**(44)**	110	**(74)**	354
Total gains (losses) on financial instruments	**$ (17,988)**	$ 5,738	**$ (34,916)**	$ 43,866

For most of 2013, Canadian capital markets were relatively upbeat. The impact of an improving global economy and recovery in Canada meant that bond yields increased and prices fell. This momentum faltered in early 2014 and 5-year bond yields dropped by 0.43% in the first six months of the year. Despite a slight rebound in the third quarter of 2014, bond yields finished the year lower at about 1.34%, down about 0.29% in the quarter and down 0.60% for the year.

For the Company, this meant the value of holding short bond positions as a hedge against its mortgages pending securitization decreased in the year and it recorded net losses related to the valuation of these financial instruments.

The Company uses short Government of Canada bonds (including CHT-issued bonds) together with repurchase agreements to create forward interest rate contracts to hedge the interest rate risk associated with fixed rate mortgages originated for its own securitization programs. For accounting purposes, these do not qualify as interest rate hedges as the bonds used are not derivatives but simple cash-based financial instruments. These gains or losses are recorded in the period in which the bond yields change; however, the offsetting economic gains or losses are not recorded in the same period. Instead, the resulting economic gain (or loss) 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 2014, the Company recorded losses on these hedges of $41.5 million (2013 – gains of $28.7 million). While these losses decreased 2014's net income, the gross spread on the related portfolio of securitized mortgages going forward will be proportionally wider as the Company issued securitization-related debt at lower relative interest rates than it would have prior to the movement in bond yields. In order to adequately hedge its interest rate exposure, the Company had more than $1.3 billion of bonds sold short at the end of the 2014 year.

The portion of the Company's mortgages which is held at fair value (primarily those funded through ABCP), was affected positively by the change in yields; however, these gains were offset by losses on the value of the interest rate swaps, which were used to hedge all fixed-rate mortgages in this portfolio. The mortgages were favourably affected by lower rates of prepayment and the tightening of mortgage funding spreads experienced within the quarter, which made existing mortgages comparatively more valuable.

The net fair value of the gains and losses on all mortgages held at fair value and the related swaps was a $6.3 million net gain for the year.

Brokerage Fees Expense

Brokerage fees expense decreased 9% to $77.1 million from $84.4 million. This decrease is explained almost entirely by lower origination volumes of single-family mortgages for institutional investors, which decreased by 11%. The remainder of the difference is explained by a higher allocation to capitalized mortgage broker fees in 2013 in comparison to 2014.

Salaries and Benefits Expense

Salaries and benefits expense increased 9% to $67.6 million from $62.0 million. The increase is due primarily to an increase in headcount and higher employee costs associated with commercial segment origination. The Company compensates its commercial sales staff with commissions based on originated mortgages. Commercial origination including renewals increased by 16% between 2014 and 2013, and sales compensation increased by $1.0 million year over year. As at December 31, 2014, the Company had 770 employees, compared to 663 as at December 31, 2013. The growth in head count also includes 49 employees hired in the fourth quarter of 2014 for the new third-party underwriting processing business. The Company expensed $0.9 million of employee costs in the fourth quarter related to these hires. These employees were added in 2014 so that appropriate training, regulatory registration and other initiatives could take place prior to the 2015 launch dates. Without these employees, headcount increased by 9% largely to meet the administrative demand associated with the increased MUA, which grew by 14% year over year.

Management salaries were paid to the two senior executives (Co-founders) who together control about 77% of the Company's common shares. The current period expense is a result of the compensation arrangement executed on the closing of the initial public offering ("IPO").

Interest Expense

Interest expense increased 24% to $36.3 million in 2014 from $29.2 million in 2013. As discussed in the "Liquidity and Capital 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 used the debenture together with a $1 billion credit facility with a syndicate of banks and 30-day repurchase facilities to fund the mortgages during this period. The overall interest expense has increased from the prior period due to increased use of these facilities to warehouse the larger amounts of mortgages originated for the Company's securitization programs.

Other Operating and Amortization of Intangibles Expenses

Other operating and amortization of intangibles expenses increased 7% to $47.1 million from $44.1 million. The amortization of intangible assets recognized on the IPO was $5.0 million in 2014 compared to $5.6 million in 2013 as some of these assets became fully amortized in 2013. Other operating expenses increased by $3.6 million as the costs saved on lower hedging and mortgage servicing were offset by about $0.7 million of expenses related to the third party underwriting and fulfillment processing services business which the Company entered into early in the third quarter of 2014.

Income before Income Taxes and Pre-FMV EBITDA

Income before income taxes decreased 40% to $140.3 million from $233.5 million. The decrease was due in large part to volatility in the bond market, which negatively affected the Company's interest rate hedges. Income before income taxes was comparatively lower in 2014 than 2013 by $78.8 million because of the unfavourable change in gains and losses on financial instruments. Pre-FMV EBITDA, which eliminates the impact of gains and losses on financial instruments, decreased 7% to $183.1 million from $197.6 million. The decrease was due to the increasing competitiveness in the market for mortgages. As mortgage spreads have tightened as a result of competition, the Company's net interest margin has not grown as rapidly as the volume of mortgages it has originated for this business. The competitive landscape has also led to lower pricing on placement and mortgage servicing fees as institutional investors sought to increase the return they derive from the mortgages purchased from the Company.

Provision for Income Taxes

The provision for taxes decreased by 42% to $35.8 million from $61.4 million. The provision is lower due primarily to the decreased earnings recorded in 2014 compared to those in 2013.

Operating Segment Review

The Company aggregates its business from two segments for financial reporting purposes: (1) Residential (which includes single-family residential mortgages); and (2) Commercial (which includes multi-unit residential and commercial mortgages), as summarized below:

Operating Business Segments

($000s except percent amounts)

	RESIDENTIAL		COMMERCIAL	
Year ended	**December 31, 2014**	**December 31, 2013**	**December 31, 2014**	**December 31, 2013**
Originations and renewals	**$ 15,889,345**	$ 15,328,929	**$ 5,007,918**	$ 4,306,626
Percentage change	**4%**		**16%**	
Revenue	**$ 608,471**	$ 590,976	**$ 194,636**	$ 185,532
Percentage change	**3%**		**5%**	
Income before income taxes	**$ 95,631**	$ 175,049	**$ 44,674**	$ 58,462
Percentage change	**(45%)**		**(24%)**	
Period ended	**December 31, 2014**	**December 31, 2013**	**December 31, 2014**	**December 31, 2013**
Identifiable assets	**$ 21,112,421**	$ 16,282,131	**$ 4,811,717**	$ 4,257,310
Mortgages under administration	**$ 66,991,706**	$ 57,652,258	**$ 18,897,855**	$ 17,966,745

Residential Segment

Overall residential origination including renewals increased by 4% between 2014 and 2013 while residential revenues increased by about 3%. Part of the change in revenue is due to the change in gains and losses on financial instruments. Excluding these changes, revenue increased by 14% as the securitized mortgage portfolio grew and produced higher interest revenue. The net change in gains and losses on financial instruments of $60.5 million also affected net income before income taxes.

Without the impact of this large unfavourable fair value change, net income before income taxes for the residential segment would have decreased by 13% year over year, indicative of lower mortgage servicing and net placement fee revenue as the Company elected to securitize a greater portion of its origination. Identifiable assets increased since December 31, 2013, as the Company added about $3.8 billion of net single-family mortgages to mortgages pledged under securitization, $325 million of mortgages accumulated for securitization and more than $300 million of government bonds purchased for hedging purposes.

Commercial Segment

Commercial revenues increased by almost 5% from the prior year, and increased by 16% if the impact of changes in gains and losses on the fair value of financial instruments are excluded. This growth is due to a larger securitized mortgage portfolio in the Company's commercial segment offset by tighter spreads on the securitized mortgages and deferred placement fees as the multi-unit residential mortgage market became more competitive. Without fair value amounts, net income before tax increased by 9% year over year, as higher placement fees in 2014 offset lower income from deferred placement. Identifiable assets increased since December 31, 2013, as the Company increased its securitized portfolio of multi-unit residential mortgages through NHA-MBS by about $600 million.

Liquidity and Capital Resources

The Company's fundamental liquidity strategy has been to invest 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 bid. As the Company's results in those years showed, First National had little, if any, trouble finding investors to purchase its mortgage origination at profitable margins. Originating prime mortgages also allows the Company to securitize in the capital markets; however, this activity requires significant cash resources to purchase and hold mortgages prior to arranging for term debt through the securitization markets. For this purpose, the Company uses the combination of the $175 million debenture loan and the Company's revolving bank credit facility.

This aggregate indebtedness is typically used to fund: (1) mortgages accumulated for sale or securitization, (2) the origination costs associated with securitization, and (3) mortgage and loan investments. The Company has a credit facility with a syndicate of eleven financial institutions for a total credit of $1 billion. This facility was closed in January 2014 for a four-year term. Bank indebtedness may also include borrowings obtained through overdraft facilities. At December 31, 2014, the Company entered into repurchase transactions with financial institutions to borrow $660 million related to $680 million of mortgages held in "mortgages accumulated for sale or securitization" on the balance sheet.

At December 31, 2014, outstanding bank indebtedness (excluding bank indebtedness at the Fund level) was $601.9 million (December 31, 2013 - $260.3 million). Together with the debenture financing of $175 million (December 31, 2013 - $175 million), this "combined debt" was used to fund $690.2 million (December 31, 2013 - $454.8 million) of mortgages accumulated for sale or securitization. At December 31, 2014, the Company's other interest-yielding assets included: (1) deferred placement fees receivable of $34.6 million (December 31, 2013 – $33.6 million) and (2) mortgage and loan investments of $230.4 million (December 31, 2013 - $184.6 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 31, 2013 and December 31, 2014, and now stands at $86.7 million (December 31, 2013 – $Nil). This represents a debt-to-equity ratio of approximately 0.21 to 1, which the Company believes is very conservative.

This ratio increased from December 31, 2013 when there was no "true leverage" as the Company invested $52 million in net new mortgage securitizations and $40 million in new mortgage and loan investments.

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 on a dollar-for-dollar basis for all mortgages not registered with the custodian. Due to the difficulty in obtaining evidence from land registry offices on a timely basis, the Company has been required to post cash collateral for the pending title transfers. At December 31, 2014, $Nil million (December 31, 2013 - $4.8 million) of this collateral was held by the custodian. When this collateral is required, it is 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, 2014, the investment in cash collateral was $19.0 million (December 31, 2013 - $20.0 million).

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. 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 2014, the Company will receive approximately $80 million of cash, annually, from its servicing operations and $123 million of annually cash flow from securitization transaction spread and deferred placement fees receivables.

Together, on an after-tax basis, this $150 million of annual cash flow would be more than sufficient to support the annual dividends of $90 million on the common shares and the $4.65 million on the preference 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 Class A preference shares, Series 1 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 on the outstanding common shares and on a quarterly basis on the outstanding preference 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 the Company to Canadian residents on both common and preference shares after December 31, 2010, are designated as "eligible dividends". Unless stated otherwise, all dividends (and deemed dividends) paid by the Company hereafter are designated as "eligible dividends" for the purposes of such rules. For the preference 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, certain mortgages pledged under securitization that have been funded with ABCP and NHA-MBS debt and several mortgages within mortgage and loan investments, as financial assets measured 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. As rates in the bond market change, the carrying values of these assets will change. 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 designed 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 economic 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 mortgages 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 some 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, 2014, the Company had $974 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, 2014, the Company had entered into $86 million of notional value forward bond sales for this segment. The total net value of realized and unrealized gains and losses on account of all notional hedges pertaining to the period January 1, 2014 to December 31, 2014 was a $41.5 million loss. This amount has been included in revenue in the statement of comprehensive income.

Upon 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 was $1.4 million as at December 31, 2014. 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 $1.4 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 three 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, 2014, the aggregate notional value of these swaps was $28.9 million. During the year the value of these swaps decreased by about $0.1 million. The amortizing swaps mature between July 2015 and June 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 widened. 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 losses 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, the Company 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 March 2011 and continuing until the current period, it was priced at a discount to BAs. At the same time the Company has leveraged on changing credit spreads. The success of this approach 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, 2014, the Company had various exposures to changing credit spreads. In particular, in mortgages accumulated for sale or securitization, there were almost $1.4 billion 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 may require 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, 2014, the Company equipped a new floor at its head office for growth of its administration department and purchased new computers and office and communications equipment primarily to support its single-family residential business. In the long term, the Company expects capital expenditures on fixed assets will be approximately $4.0 million annually; however, in the next year, there will be greater expenditures required to support the new third-party underwriting business.

Summary of Contractual Obligations

The Company's long-term obligations include five- to 10-year premises leases for its five 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 Years	1-3 Years	4-5 Years	After 5 Years
Lease Obligations	$ 25,998	$ 5,966	$ 12,160	$ 4,989	$ 2,883

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 that 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, 2014. 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 fees 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, which average approximately 11% for single-family mortgages. The Company assumes there is virtually no prepayment on multi-unit residential fixed rate mortgages.

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, 2014 continue to be consistent with those used for the year ended December 31, 2013 and the quarters ended September 30, June 30 and March 31, 2014.

The Company has elected to treat its financial assets and liabilities, including deferred placement fees receivable, specific mortgages pledged under securitization, 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 securitized mortgages has a significant impact on earnings. The Company uses different prepayment rates for its various programs, which average approximately 10% for single-family mortgages. The Company assumes there is virtually no prepayment on multi-unit residential fixed rate mortgages. Actual prepayment experience has been consistent with these assumptions. The Company 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

In July 2014, the IASB issued the final version of IFRS 9 – Financial Instrument, replacing IAS 39 and all previous versions of IFRS 9. This final version of IFRS 9 includes a logical 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 OCI, 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; 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 process of evaluating the impact of IFRS 9 on the Company's financial statements.

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 ending on or after December 31, 2017. The Company intends to adopt IFRS 15 in its financial statements for the annual period beginning on January 1, 2017 and is currently analyzing the impact on the Company's financial statements.

Disclosure Controls and Internal Controls over Financial Reporting

The Company's disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by the Company in reports filed under Canadian securities laws is recorded, processed, summarized and reported within the time periods specified under those laws, and include controls and procedures that are designed to ensure that information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

As of December 31, 2014, management evaluated, under the supervision of and with the participation of the Chief Executive Officer and Chief Financial Officer, the effectiveness of the Company's disclosure controls and procedures. Based on this evaluation, management concluded that the Company's disclosure controls and procedures, as defined by National Instrument 52-109, Certification of Disclosure in Issuers' Annual and Interim Filings, were effective as of December 31, 2014.

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.

Management evaluated, under the supervision of and with the participation of the Chief Executive Officer and Chief Financial Officer, the effectiveness of the Company's internal control over financial reporting based on the criteria set forth in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") and, based on that evaluation, concluded that the Company's

internal control over financial reporting was effective as of December 31, 2014 and that no material weaknesses have been identified in the Company's internal control over financial reporting as of December 31, 2014. No changes were made in the Company's internal controls over financial reporting during the year ended December 31, 2014 that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

Risks 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. In addition to the risks addressed elsewhere in this discussion and the financial statements, these risks include: 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, legislation and government regulation (including the policies set for mortgage default insurance companies), competition, reliance on mortgage insurers, reliance on key personnel and the ability to attract and retain employees and executives, 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, and environmental liability. In addition, risks associated with the structure of the Company 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 the Company's 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, reference should be made to the Company's Annual Information Form.

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 as 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 24, 2015, 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

Management is pleased with the results of 2014 particularly with the record origination volumes realized as the Company took advantage of a strong real estate market. Looking ahead, the Company anticipates continuing strength in Canadian real estate and the continuation of its leadership position in the mortgage broker distribution channel. With the cut in the Bank of Canada overnight rate announced in January 2015 the Company's expectation of a low interest rate environment for 2015 has been reinforced. Low rates will continue to keep mortgage affordability at favourable levels and allay refinancing risk. During the fourth quarter of 2014, the Company incurred employee costs, training, recruiting and other start-up costs in conjunction with the mortgage underwriting and fulfillment processing services agreement it announced on July 16, 2014. Although operations from this agreement commenced in January 2015, revenue will not be earned until the mortgages underwritten fund later in the first quarter. Accordingly to start 2015, this new business may produce little if any marginal earnings for the Company's bottom line.

By realizing the significant renewal opportunities available in the upcoming year and managing its partnerships with institutional customers, the Company will continue to focus on sustainable profitability. Management expects the Company to continue to generate the cash flow from its $22 billion portfolio of mortgages pledged under securitization and $64 billion servicing portfolio that will maximize financial performance.

Management's Responsibility for Financial Reporting

The management of First National Financial Corporation (the "Company") is responsible for the preparation and fair presentation of the accompanying annual consolidated financial statements and Management's Discussion and Analysis ("MD&A"). The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS").

The consolidated financial statements and information in the MD&A necessarily include amounts based on the best estimates and judgments by management of the expected effects of current events and transactions with the appropriate consideration to materiality. In addition, in preparing this financial information the Company must make determinations about the relevancy of information to be included, and estimates and assumptions that affect the reported information. The MD&A also includes information regarding the impact of current transactions and events, sources of liquidity and capital resources, operating trends, risks and uncertainties. Actual results in the future may differ materially from our present assessment of this information because future events and circumstances may not occur as expected.

In meeting our responsibility for the integrity and fairness of the annual consolidated financial statements and MD&A and for the accounting systems from which they are derived, management has established the necessary internal controls designed to ensure that the Company's financial records are reliable for preparing financial statements and other financial information, transactions are properly authorized and recorded, and assets are safeguarded against unauthorized use or disposition.

As at December 31, 2014, the Chairman, President and Chief Executive Office and Chief Financial Officer evaluated, or caused an evaluation under their direct supervision, of the design and operation of our internal controls over financial reporting (as defined in National Instrument 52-109, Certificate of Disclosure in Issuers' Annual and Interim Filings) and, based on that assessment, determined that the Company's internal controls over financial reporting were appropriately designed and operating effectively.

Management's Responsibility for Financial Reporting

The Board of Directors oversees through an Audit Committee, which is composed entirely of independent directors. This committee reviews the Company's annual consolidated financial statements and MD&A with both management and the independent auditors before such statements are approved by the Board of Directors. Other key responsibilities of the Audit Committee include selecting the Company's auditors, approving the Company's interim unaudited condensed consolidated financial statements and MD&A, and monitoring the Company's existing systems of internal controls.

Ernst & Young LLP, independent auditors appointed by the shareholders of First National Financial Corporation upon the recommendation of the Board of Directors, have examined the Company's 2014 and 2013 annual consolidated financial statements and have expressed their opinion upon the completion of such examination in the following report to the shareholders. The auditors have full and free access to, and meet at least quarterly with, the Audit Committee to discuss their audit and related matters.

Stephen J.R. Smith
Chairman and Chief Executive Officer

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, 2014 and 2013, 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, 2014 and 2013, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Toronto, Canada
February 24, 2015

Chartered Professional Accountants
Licensed Public Accountants

Consolidated Statements of Financial Position

As at December 31 ($000s)

	Notes	2014 $	2013 $
ASSETS			
Restricted cash	3	$ **496,733**	$ 431,111
Accounts receivable and sundry		**71,160**	60,110
Securities purchased under resale agreements and owned	15	**1,331,615**	1,055,443
Mortgages accumulated for sale or securitization	5	**1,369,778**	1,074,825
Mortgages pledged under securitization	3	**22,337,378**	17,651,644
Deferred placement fees receivable	4	**34,644**	33,580
Cash held as collateral for securitization	3	**18,973**	24,804
Purchased mortgage servicing rights	8	**2,230**	3,079
Mortgage and loan investments	6	**230,388**	184,584
Income taxes recoverable	19	**10,539**	—
Other assets	7	**50,476**	50,037
Total assets		$ **25,953,914**	$ 20,569,217
LIABILITIES AND EQUITY			
Liabilities			
Bank indebtedness	10	**609,870**	274,484
Obligations related to securities and mortgages sold under repurchase agreements	16	**660,360**	609,292
Accounts payable and accrued liabilities	17	**94,524**	66,426
Securities sold under repurchase agreements and sold short	15	**1,330,699**	1,050,199
Debt related to securitized and participation mortgages	11	**22,573,362**	17,884,303
Debenture loan payable	13	**176,418**	179,195
Income taxes payable	19	**—**	4,207
Deferred tax liabilities	19	**57,400**	51,200
Total liabilities		$ **25,502,633**	$ 20,119,306
EQUITY ATTRIBUTABLE TO SHAREHOLDERS			
Common shares	18	$ **122,671**	122,671
Preferred shares	18	**97,394**	97,394
Retained earnings		**192,669**	184,561
		412,734	404,626
Non-controlling interests		**38,547**	45,285
Total equity		**451,281**	449,911
Total liabilities and equity		$ **25,953,914**	$ 20,569,217

See accompanying notes

On behalf of the Board:

John Brough

Robert Mitchell

Consolidated Statements of Comprehensive Income

As at December 31 ($000s, except earnings per share)

	Notes	2014	2013
REVENUE			
Interest revenue – securitized mortgages		$ 550,216	$ 429,223
Interest expense – securitized mortgages		(434,726)	(323,236)
Net interest – securitized mortgages	3	115,490	105,987
Placement fees		127,129	145,407
Gains on deferred placement fees	4	10,520	11,021
Mortgage investment income		57,076	54,166
Mortgage servicing income		93,082	92,825
Realized and unrealized gains (losses) on financial instruments		(34,916)	43,866
		368,381	453,272
EXPENSES			
Brokerage fees		77,105	84,420
Salaries and benefits		67,551	62,029
Interest		36,275	29,170
Other operating		42,145	38,579
Amortization of intangible assets		5,000	5,563
		228,076	219,761
Income before income taxes		140,305	233,511
Income tax	19	35,840	61,410
Net income and comprehensive income for the year		104,465	172,101
Net income and comprehensive income attributable to:			
Shareholders		101,710	169,726
Non-controlling interests		2,755	2,375
		$ 104,465	$ 172,101
Earnings per share			
Basic	18	$ 1.62	$ 2.75

See accompanying notes

Consolidated Statements of Changes in Equity

Years ended December 31 ($000s)

	Common shares	Preferred shares	Retained earnings	Non-controlling interest	Total equity
Balance at January 1, 2014	**$ 122,671**	**$ 97,394**	**$ 184,561**	**$ 45,285**	**$ 449,911**
Comprehensive income	—	—	101,710	2,755	104,465
Dividends paid or declared	—	—	(93,602)	(2,714)	(96,316)
Non-controlling interests redemption	—	—	—	(6,779)	(6,779)
Balance at December 31, 2014	**$ 122,671**	**$ 97,394**	**$ 192,669**	**$ 38,547**	**$ 451,281**

	Common shares	Preferred shares	Retained earnings	Non-controlling interest	Total equity
Balance at January 1, 2013	$ 122,671	$ 97,394	$ 102,440	$ 42,895	$ 365,400
Comprehensive income	—	—	169,726	2,375	172,101
Dividends paid or declared	—	—	(87,605)	(2,689)	(90,294)
Non-controlling interests redemption	—	—	—	2,704	2,704
Balance at December 31, 2013	**$ 122,671**	**$ 97,394**	**$ 184,561**	**$ 45,285**	**$ 449,911**

See accompanying notes

Consolidated Statements of Cash Flows

Years ended December 31 ($000s)

	2014	2013
OPERATING ACTIVITIES		
Net income for the year	$ 104,465	$ 172,101
Add (deduct) items not affecting cash:		
Deferred income tax expense	6,200	18,300
Non-cash portion of gains on deferred placement fees	(9,785)	(9,912)
Increase in restricted cash	(65,622)	(96,149)
Net investment in mortgages pledged under securitization	(4,670,001)	(4,600,694)
Net increase in debt related to securitized mortgages	4,683,052	4,630,915
Amortization of deferred placement fees receivable	9,028	17,955
Amortization of purchased mortgage servicing rights	849	802
Amortization of property, plant and equipment	2,909	2,374
Amortization of intangible assets	5,000	5,563
Unrealized losses (gains) on financial instruments	8,590	(19,286)
	74,685	121,969
Net change in non-cash working capital balances related to operations	(305,398)	(272,641)
Cash used in operating activities	$ (230,713)	$ (150,672)
INVESTING ACTIVITIES		
Additions to property, plant and equipment	(8,348)	(3,428)
Repayment of cash held as collateral for securitization	5,831	44,689
Investment in mortgage and loan investments	(223,962)	(142,353)
Repayment of mortgage and loan investments	178,158	130,803
Cash provided by (used in) investing activities	$ (48,321)	$ 29,711
FINANCING ACTIVITIES		
Dividends paid	$ (93,102)	$ (87,106)
Obligations related to securities and mortgages sold under repurchase agreements	51,068	108,684
Debt related to participation mortgages	6,007	(19,422)
Securities purchased under resale agreements and owned, net	(276,172)	(602,909)
Securities sold under repurchase agreements and sold short, net	265,340	602,412
Non-controlling interest	(9,493)	15
Cash provided by (used in) financing activities	$ (56,352)	$ 1,674
Net increase in bank indebtedness during the year	(335,386)	(119,287)
Bank indebtedness, beginning of year	(274,484)	(155,197)
Bank indebtedness, end of year	$ (609,870)	$ (274,484)
Supplemental cash flow information		
Interest received	$ 655,018	$ 536,524
Interest paid	449,287	335,516
Income taxes paid	44,386	40,693

See accompanying notes

Notes to Consolidated Financial Statements

December 31, 2014 and 2013

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 almost $86 billion in mortgages under administration as at December 31, 2014, 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 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"). 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 24, 2015.

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), 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 Trust were created in 2012 as special purpose vehicles ("SPE") to obtain exposure to a diversified portfolio of high yielding mortgages. While the Company has legal ownership of approximately 16% 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 had de facto control of the both the Fund and Trust, and therefore, had consolidated the operations and net assets of the Fund and Trust.

Non-controlling interests in the Fund and 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 interest is also separately disclosed on the consolidated statement of comprehensive income.

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, 2014, the Company recorded, on its consolidated statements of financial position, its portion of assets of an SPE amounting to $242 million (2013 – $424 million). The Company also recorded, on its Consolidated Statements of Comprehensive Income, interest revenue – securitized mortgages of $8.6 million (2013 – $10.7 million) and interest expense – securitized mortgages of $6.7 million (2013 – $7.6 million).

The consolidated financial statements have been prepared using consistent accounting policies for like transactions and other events in similar circumstances. All intercompany 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 financial liabilities at fair value.

2.4 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.

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.

Capitalized origination fees and debt discounts or premiums are respectively 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;
- 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 that 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 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 its value based on the net present value of future expected cash flows, calculated using management's best estimates of key assumptions related to expected prepayment rates and discount rates commensurate with the risks involved.

MORTGAGE SERVICING INCOME

The Company services substantially all of the mortgages that it originates whether the mortgage is placed with an institutional investor or transferred to a securitization vehicle. In addition, mortgages are serviced on behalf of third-party institutional investors and securitization structures. For all mortgages administered for investors or third parties, the Company recognizes servicing income when services are rendered. For mortgages placed under deferred placement arrangements, the Company retains the rights and obligations to service the mortgages. The deferred placement fees receivable is the present value of the excess retained cash flows over 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 the servicing liability is recorded 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. Brokerage fees 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 at 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.

The Company has elected to measure certain of its assets at FVTPL. The most significant of these assets include: a large 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 held for trading (together with other ABCP funded mortgages, "FVTPL mortgages"). For the large 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 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 the bank credit facility. Accordingly, the Company manages these assets on a fair value basis.

Financial assets and financial liabilities at FVTPL are initially recognized at fair value. Subsequent gains and losses arising from changes in fair value are recognized directly 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 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.

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.

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, primarily 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. Origination costs, such as brokerage fees, bulk insurance premiums 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. 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 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 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 funded mortgages that it intends to securitize in subsequent periods.

Bonds sold short are classified as FVTPL 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 classified as loans and receivables, 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 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 and customer service contracts and 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 as follows:

Broker relationships	Straight-line 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.

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 can be 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 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 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.

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 statements of comprehensive income, 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 statements of comprehensive income over the period to maturity or derecognition.

New accounting policies adopted

On January 1, 2014, the Company adopted IFRIC 21 Levies, issued by the IASB. The adoption of the standard did not have a significant impact on the Company's consolidated financial statements.

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, 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 collateral in some circumstances. As at December 31, 2014, the cash held as collateral for securitization was $18,973 (2013 – $24,804).

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

2014

	Carrying amount of securitized mortgages	Carrying amount of associated liabilities
Securitized mortgages at face value	$ 22,170,195	$ 22,612,160
Mark-to-market adjustment	41,859	—
Capitalized origination costs	125,324	—
Debt discounts	—	(56,481)
	22,337,378	22,555,679
Add:		
Principal portion of payments held in restricted cash	455,003	—
Participation debt	—	17,683
	$ 22,792,381	$ 22,573,362

2013

	Carrying amount of securitized mortgages	Carrying amount of associated liabilities
Securitized mortgages at face value	$ 17,532,693	$ 17,919,788
Mark-to-market adjustment	37,956	—
Capitalized origination costs	80,995	—
Debt discounts	—	(47,161)
	17,651,644	17,872,627
Add		
Principal portion of payments held in restricted cash	398,285	—
Participation debt	—	11,676
	$ 18,049,929	$ 17,884,303

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

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

	2014	2013
Opening balance, January 1	**$ 80,995**	$ 55,130
Add: new origination costs capitalized in the year	**86,449**	56,542
Less: amortization in the year	**(42,120)**	(30,677)
Ending balance, December 31	**$ 125,324**	$ 80,995

During the year ended December 31, 2014, the Company invested in mortgages that were transferred into the securitization vehicles of $7,094,528 (2013 – $6,532,494).

As at December 31, 2014, mortgages pledged under securitization include $21,985,346 (2013 – $17,440,211) of insured mortgages and $184,849 (2013 – $92,482) of uninsured mortgages.

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

2015	$ 2,760,503
2016	2,977,333
2017	3,597,619
2018	4,499,764
2019 and thereafter	8,334,976
	$ 22,170,195

The mortgages securitized through NHA-MBS and CMB programs have been classified as loans and receivables, except for approximately $1.2 billion (2013 – $1.1 billon) of mortgages included in FVTPL mortgages. These mortgages are carried at par plus an adjustment for unamortized origination costs. Most mortgages in bank-sponsored ABCP programs have been classified as FVTPL.

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

Arrears days	2014	2013
31 to 60	**$ 71,170**	$ 71,634
61 to 90	**11,353**	15,388
Greater than 90	**53,389**	30,284
	$ 135,912	$ 117,306

The Company did not set up allowance for mortgages past due over 90 days, as almost 100% of the mortgages are insured.

Interest revenue — securitized mortgages consists of $105,130 (2013 – $100,160) of interest revenue related to ABCP funded mortgages, which are mostly measured at fair value and $445,086 (2013 – $329,063) of interest revenue related to mortgages pledged under securitization and securitized mortgages included in FVTPL mortgages.

The Company uses various assumptions to value the 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:

	2014	
	Commercial mortgages	Residential mortgages
FVTPL mortgages	$ 152,542	$ 3,249,160
Average life (in months) [1]	30	23
Prepayment speed assumption (annual rate)	0.4%	11.5%
Impact on fair value of 10% adverse change	$ 1	$ 477
Impact on fair value of 20% adverse change	$ 1	$ 951
Discount rate (annual rate)	2.2%	2.0%
Impact on fair value of 10% adverse change	$ 819	$ 10,152
Impact on fair value of 20% adverse change	$ 1,626	$ 20,248

	2013	
	Commercial mortgages	Residential mortgages
FVTPL mortgages	$ 190,939	$ 3,097,341
Average life (in months) [1]	24	27
Prepayment speed assumption (annual rate)	8.2%	11.6%
Impact on fair value of 10% adverse change	$4	$517
Impact on fair value of 20% adverse change	$8	$ 1,028
Discount rate (annual rate)	2.3%	2.1%
Impact on fair value of 10% adverse change	$ 968	$ 12,156
Impact on fair value of 20% adverse change	$ 1,914	$ 24,230

[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, 2014, $2,088,783 (2013 – $1,881,030) of mortgages were placed with institutional investors, which created gains on deferred placement fees of $10,520 (2013 – $11,021). Cash receipts on deferred placement fees receivable for the year ended December 31, 2014 were $9,718 (2013 – $18,919).

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. As at December 31, 2014, the fair value of deferred placement fees receivable is $34,644 (2013 – $33,580). An assumption of no credit losses 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. 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:

	2014	
	Commercial mortgages	Residential mortgages
Average life (in months) [1]	60	26
Prepayment speed assumption (annual rate)	—	15.0%
Impact on fair value of 10% adverse change	—	$2
Impact on fair value of 20% adverse change	—	$5
Residual cash flows discount rate (annual rate)	4.4%	4.0%
Impact on fair value of 10% adverse change	$ 380	$ 1
Impact on fair value of 20% adverse change	$ 752	$ 1

	2013	
	Commercial mortgages	**Residential mortgages**
Average life (in months) [1]	54	24
Prepayment speed assumption (annual rate)	—	15.0%
Impact on fair value of 10% adverse change	—	$1
Impact on fair value of 20% adverse change	—	$2
Residual cash flows discount rate (annual rate)	4.8%	4.8%
Impact on fair value of 10% adverse change	$ 393	—
Impact on fair value of 20% adverse change	$ 778	$ 1

[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:

2015	$ 9,117
2016	8,165
2017	7,053
2018	5,643
2019 and thereafter	8,904
	$ 38,882

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 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 held for trading approximate their carrying values due to their short-term nature. The following table summarizes the components of mortgages according to their classification:

	2014	2013
Mortgages accumulated for securitization	**$ 1,354,572**	$ 1,063,068
Mortgages accumulated for sale	**15,206**	11,757
	$ 1,369,778	$ 1,074,825

Note 6.

Mortgage and Loan Investments

As at December 31, 2014, 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:

	2014	2013
Mortgage loans, classified as loans and receivables	**$ 175,570**	$ 115,630
Mortgage loans, designated as FVTPL	**54,818**	68,954
	$ 230,388	$ 184,584

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, 2014:

Province/Territory		Portfolio balance		Percentage of portfolio
Alberta	$	**24,336**	%	10.56
British Columbia		**6,594**		2.86
Manitoba		**43,199**		18.75
New Brunswick		**2,361**		1.02
Newfoundland and Labrador		**3,179**		1.38
Nova Scotia		**4,323**		1.88
Ontario		**111,336**		48.34
Quebec		**30,255**		13.13
Saskatchewan		**3,966**		1.72
Yukon		**839**		0.36
	$	**230,388**	%	100.00

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

Arrears days		2014		2013
31 to 60	$	**4,596**	$	278
61 to 90		**—**		409
Greater than 90		**34,453**		15,216
	$	**39,049**	$	15,903

The portfolio contains $5,050 (2013 – $3,900) of insured mortgages and $225,338 (2013 – $180,684) of uninsured mortgage and loan investments as at December 31, 2014. Of the above total amount, the Company considers $5,116 (2013 – $4,914) as impaired, for which it has provided an allowance for potential loss of $4,041 (2013 – $4,041) as at December 31, 2014.

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

	2014						2013
	2015	2016	2017	2018	2019 and thereafter	Book value	Book value
Residential	$ 14,055	$ 249	$ 1,004	$ 742	$ 6,734	$ 22,784	$ 18,357
Commercial	146,479	43,300	13,191	3,795	839	207,604	166,227
	$ 160,534	$ 43,549	$ 14,195	$ 4,537	$ 7,573	$ 230,388	$ 184,584

Interest income for the year was $13,607 (2013 – $9,420) and is included in mortgage investment income on the consolidated statements of comprehensive income.

Note 7.

Other Assets

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

	2014	2013
Property, plant and equipment, net	**$ 13,200**	$ 7,761
Intangible assets, net	**7,500**	12,500
Goodwill	**29,776**	29,776
	$ 50,476	$ 50,037

The intangible assets have a remaining amortization period of less than two 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:

	2014			2013		
	Cost	**Accumulated amortization**	**Net book value**	**Cost**	**Accumulated amortization**	**Net book value**
Third-party commercial mortgage servicing rights	**$ 3,614**	**$ 3,287**	**$ 327**	$ 3,614	$ 3,183	$ 431
Commercial mortgage-backed securities primary and master servicing rights	**8,705**	**6,802**	**1,903**	8,705	6,057	2,648
	$ 12,319	**$ 10,089**	**$ 2,230**	$ 12,319	$ 9,240	$ 3,079

Amortization charged to income for the year ended December 31, 2014 was $849 (2013 – $802).

Note 9.

Mortgages under Administration

As at December 31, 2014, the Company had mortgages under administration of $85,889,561 (2013 – $75,619,003), 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, trustcompanies, credit unions and securitization vehicles. As at December 31, 2014, the Company administered 274,674 mortgages (2013 – 245,291) for 92 institutional investors (2013 – 91) with an average remaining term to maturity of 42 months (2013 – 42 months).

Mortgages under administration are serviced as follows:

	2014	2013
Institutional investors	**$ 53,625,460**	$ 48,245,957
Mortgages accumulated for sale or securitization and mortgage and loan investments	**1,593,103**	1,255,267
Securitization vehicles, deferred placement investors	**5,197,507**	5,075,254
Mortgages pledged under securitization	**22,170,195**	17,532,693
CMBS conduits	**3,303,296**	3,509,832
	$ 85,889,561	$ 75,619,003

The Company's exposure to credit loss is limited to mortgages under administration totalling $336,998 (2013 – $201,271), of which $1,328 of mortgages have principal and interest payments in arrears as at December 31, 2014 (2013 – $4,971). The Company incurred actual credit losses, net of recoveries, of $625 during the year ended December 31, 2014 (2013 – $3,752). As at December 31, 2014, the Company has $17,462 (2013 – $7,687) of uninsured non-performing mortgages (net of provisions for credit losses) included in accounts receivable and sundry.

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, 2014 was $537,524 (2013 – $405,426).

Note 10.

Bank Indebtedness

Bank indebtedness includes a revolving credit facility of $1,000,000 (2013 – $570,000) maturing in January 2018, of which $609,639 (2013 – $258,421) was drawn as at December 31, 2014 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.

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, 2014, debt related to securitized mortgages was $22,555,678 (2013 – $17,872,627), net of unamortized discounts of $56,482 (2013 – $47,161). A comparison of the carrying amounts of the pledged mortgages and the related debt is summarized in note 3.

As at December 31, 2014, debt related to participation mortgages was $17,684 (2013 – $11,676).

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.

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 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 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, 2014 and 2013:

2014

	Less than 3 years	3 to 5 years	6 to 10 years	Total notional amount	Fair value
Interest rate swap contract	$ 261,395	$ 2,960,335	$ 11,770	$ 3,233,500	$ 8,148

2013

	Less than 3 years	3 to 5 years	6 to 10 years	Total notional amount	Fair value
Interest rate swap contract	$ 923,959	$ 1,678,567	$ 13,283	$ 2,615,809	$ 2,987

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.

Note 13.

Debenture Loan Payable

The $175 million of five-year term senior secured debentures, with an interest rate of 5.07%, maturing on May 7, 2015, are secured on a pari-passu basis with the security under the credit facility described in bank indebtedness. The net proceeds of the issuance were invested in FNFLP. FNFLP used the proceeds of the debenture loan to repay a portion of the 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 is a full guarantor 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, 2014, the Company has the following operating lease commitments for its office premises:

2015	$ 5,965
2016	6,079
2017	6,082
2018	4,989
2019 and thereafter	2,883
	$ 25,998

Outstanding commitments for future advances on mortgages with terms of one to 10 years amounted to $889,294 as at December 31, 2014 (2013 – $803,991). 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.

Note 15.

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.

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, are based on bankers' acceptance rates and matured on or before January 30, 2015.

Note 17.

Accounts Payable and Accrued Liabilities

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

	2014	2013
Accounts payable	$ 47,138	$ 36,251
Accrued interest on securitization debt	38,380	30,175
Servicing liability	9,006	—
	$ 94,524	**$ 66,426**

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

Note 18.

Shareholders' Equity

(a) Authorized

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

(b) Capital stock

	Common shares		Preferred shares	
Balance, December 31, 2014 and 2013	# 59,967,429	$ 122,671	# 4,000,000	$ 97,394

(c) Preferred shares

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

Holders of the Class A 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) Earnings per share

	2014	2013
Net income attributable to shareholders	**$ 101,710**	$ 169,726
Less: dividends declared on preferred shares	**(4,650)**	(4,650)
Net earnings attributable to common shareholders	**97,060**	165,076
Number of common shares outstanding	**59,967,429**	59,967,429
Basic earnings per common share	**$ 1.62**	$ 2.75

Note 19.

Income Taxes

The major components of deferred tax expense for the year ended December 31 consists of the following:

	2014	2013
Related to origination and reversal of timing differences	**$ 6,200**	$ 18,300

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

	2014	2013
Income taxes relating to the prior year	**$ (560)**	$ (260)
Income taxes relating to the year	**30,200**	43,370
	29,640	43,110

The effective income tax rate reported in the consolidated statements of comprehensive income varies from the Canadian tax rate of 26.37% for the year ended December 31, 2014 (2013 – 26.37%) for the following reasons:

	2014	2013
Company's statutory tax rate	**26.37%**	26.37%
Income before income taxes	**$ 140,305**	$ 233,511
Income tax at statutory tax rate	**36,998**	61,577
Increase (decrease) resulting from		
Prior year adjustments	**(560)**	(260)
Income not subject to tax	**(998)**	(610)
Permanent differences	**277**	254
Differences in current and future tax rates	**(15)**	14
Other	**138**	435
Income tax expense	**$ 35,840**	$ 61,410

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

	2014	2013
Deferred placement fees receivable	**$ 9,136**	$ 8,855
Capitalized broker fees	**33,048**	21,358
Carrying values of mortgages pledged under securitization in excess of tax values	**11,038**	10,009
Intangible assets	**1,978**	3,296
Unamortized discount on debt related to securitized mortgages	**14,894**	12,436
Cumulative eligible capital property	**(5,639)**	(6,063)
Gains (losses) on interest rate swaps	**(5,316)**	978
Servicing liability	**(2,375)**	—
Loan loss reserves not deducted for tax purposes	**(684)**	(845)
Debenture issuance costs	**(18)**	(67)
Share issuance costs	**(198)**	(422)
Other	**1,536**	1,665
Deferred tax liabilities	**$ 57,400**	$ 51,200

The movement in significant components of the Company's deferred tax liabilities and assets for the years ended December 31, 2014 and 2013 are as follows:

	As at January 1, 2014	Recognized in income	As at December 31, 2014
DEFERRED INCOME TAX LIABILITIES			
Deferred placement fees receivable	$ 8,855	$ 281	$ 9,136
Capitalized broker fees	21,358	11,690	33,048
Carrying values of mortgages pledged under securitization in excess of tax values	10,009	1,029	11,038
Gains on interest rate swaps	978	(978)	—
Intangible assets	3,296	(1,318)	1,978
Unamortized discount on debt related to securitized mortgages	12,436	2,458	14,894
Other	1,665	(129)	1,536
Total deferred income tax liabilities	**$ 58,597**	**$ 13,033**	**$ 71,630**
DEFERRED INCOME TAX ASSETS			
Cumulative eligible capital property	(6,063)	424	(5,639)
Servicing liability	—	(2,375)	(2,375)
Loan loss reserves not deducted for tax purposes	(845)	161	(684)
Losses on interest rate swaps	—	(5,316)	(5,316)
Debenture issuance costs	(67)	49	(18)
Share issuance costs	(422)	224	(198)
Total deferred income tax assets	$ (7,397)	$ (6,833)	$ (14,230)
Net deferred income tax liabilities	**$ 51,200**	**$ 6,200**	**$ 57,400**

	As at January 1, 2013	Recognized in income	As at December 31, 2013
DEFERRED INCOME TAX LIABILITIES			
Deferred placement fees receivable	$ 11,025	$ (2,170)	$ 8,855
Capitalized broker fees	14,499	6,859	21,358
Carrying values of mortgages pledged under securitization in excess of tax values	8,168	1,841	10,009
Gains on interest rate swaps	—	978	978
Intangible assets	4,751	(1,455)	3,296
Unamortized discount on debt related to securitized mortgages	2,122	10,314	12,436
Other	2,232	(567)	1,665
Total deferred income tax liabilities	**$ 42,797**	**$ 15,800**	**$ 58,597**
DEFERRED INCOME TAX ASSETS			
Cumulative eligible capital property	(6,502)	439	(6,063)
Loan loss reserves not deducted for tax purposes	(1,583)	738	(845)
Losses on interest rate swaps	(1,051)	1,051	—
Debenture issuance costs	(117)	50	(67)
Share issuance costs	(644)	222	(422)
Total deferred income tax assets	$ (9,897)	$ 2,500	$ (7,397)
Net deferred income tax liabilities	**$ 32,900**	**$ 18,300**	**$ 51,200**

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 20.

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 the borrower 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 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 2014 and 2013.

	Decrease in interest rate		Increase in interest rate[1]	
	2014	**2013**	**2014**	**2013**
100 BASIS POINT SHIFT				
Impact on net income and equity attributable to shareholders	**$ 2,205**	$ 1,414	**$ (2,205)**	$ (1,414)
200 BASIS POINT SHIFT				
Impact on net income and equity attributable to shareholders	**$ 9,448**	$ 7,157	**$ (4,410)**	$ (2,828)

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

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, 2014, 99% (2013 – 99%) 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 outstanding cheques and 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.

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 (2013 – one) Canadian financial institution represent approximately 20% (2013 – 16%) of the Company's total revenue. During the year ended December 31, 2014, the Company placed 29% (2013 – 31%) of all mortgages it originated with that institutional investor.

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.

(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.

(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 $22,337,378 (2013 – $17,651,644) and a fair value of $22,734,523 (2013 – $17,729,958), and debt related to securitized and participation mortgages, which has a carrying value of $22,573,362 (2013 – $17,884,303), and a fair value of $22,802,804 (2013 – $17,911,851).

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

2014				
	Level 1	Level 2	Level 3	Total
FINANCIAL ASSETS				
Mortgages accumulated for sale	$ —	$ 15,206	$ —	$ 15,206
FVTPL mortgages	—	—	3,983,793	3,983,793
Deferred placement fees receivable	—	—	34,644	34,644
Mortgage and loan investments	—	—	54,818	54,818
Interest rate swaps	—	1,432	—	1,432
Total financial assets	—	16,638	4,073,255	4,089,893
Financial liabilities				
Securities sold under repurchase agreements and sold short	1,330,699	—	—	1,330,699
Interest rate swaps	—	9,580	—	9,580
Debenture loan payable	—	176,418	—	176,418
Total financial liabilities	**$ 1,330,699**	**$ 185,998**	**$ —**	**$ 1,516,697**

2013				
	Level 1	Level 2	Level 3	Total
FINANCIAL ASSETS				
Mortgages accumulated for sale	$ —	$ 11,757	$ —	$ 11,757
FVTPL mortgages	—	—	3,969,524	3,969,524
Deferred placement fees receivable	—	—	33,580	33,580
Mortgage and loan investments	—	—	68,954	68,954
Interest rate swaps	—	6,976	—	6,976
Total financial assets	**$ —**	**$ 18,733**	**$ 4,072,058**	**$ 4,090,791**
FINANCIAL LIABILITIES				
Securities sold under repurchase agreements and sold short	$ 1,050,199	$ —	—	$ 1,050,199
Interest rate swaps	—	3,639	—	3,639
Debenture loan payable	—	179,195	—	179,195
Total financial liabilities	**$ 1,050,199**	**$ 182,834**	**$ —**	**$ 1,233,033**

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, 2014 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 $8,590 (2013 – gain of $19,286). 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.

The following table presents changes in the fair values, including realized losses of $26,326 (2013 – realized gain of $24,580) of the Company's financial assets and financial liabilities for the years ended December 31, 2014 and 2013, all of which have been classified as FVTPL:

		2014		**2013**
FVTPL mortgages	$	6,337	$	15,141
Deferred placement fees receivable		307		(296)
Securities owned and sold short		(41,486)		28,667
Interest rate swaps		(74)		354
	$	**(34,916)**	**$**	**43,866**

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, 2014 and 2013. 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, 2014	Investments	Unrealized gain recorded in income	Payment and amortization	Fair value as at December 31, 2014
FINANCIAL ASSETS					
FVTPL mortgages	$ 3,969,524	$ 3,110,849	$ 15,733	$ (3,112,313)	$ 3,983,793
Deferred placement fees receivable	33,580	9,785	307	(9,028)	34,644
Mortgage and loan investments	68,954	—	—	(14,136)	54,818
	$ 4,072,058	**$ 3,120,634**	**$ 16,040**	**$ (3,135,477)**	**$ 4,073,255**

	Fair value as at January 1,2013	Investments	Unrealized gain (loss) recorded in income	Payment and amortization	Fair value as at December 31, 2013
FINANCIAL ASSETS					
FVTPL mortgages	$ 3,118,827	$ 3,546,819	$ 18,907	$ (2,715,029)	$ 3,969,524
Deferred placement fees receivable	41,919	9,912	(296)	(17,955)	33,580
Mortgage and loan investments	25,021	46,117	—	(2,184)	68,954
Total financial assets	**$ 3,185,767**	**$ 3,602,848**	**$ 18,611**	**$ (2,735,168)**	**$ 4,072,058**

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, 2014, accounts receivable and sundry have been increased by $1,418 (2013 – $4,195) to account for the swap derivative, and the debenture loan payable has been increased by the same amount.

Note 21.

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, debenture loan payable 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, 2014, the ratio was 1.85:1 (2013 – 1.1:1).

The Company was in compliance with the bank covenant throughout the year.

Note 22.

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.

	2014		
	Residential	**Commercial**	**Total**
REVENUE			
Interest revenue – securitized mortgages	$ 413,629	$ 136,587	$ 550,216
Interest expense – securitized mortgages	(322,930)	(111,796)	(434,726)
Net interest – securitized mortgages	90,699	24,791	115,490
Placement and servicing	158,644	37,171	195,815
Mortgage investment income	36,198	20,878	57,076
	285,541	**82,840**	**368,381**
EXPENSES			
Amortization	5,257	2,652	7,909
Interest	33,795	2,480	36,275
Other operating	150,858	33,034	183,892
	189,910	**38,166**	**228,076**
Income before income taxes	$ 95,631	$ 44,674	$ 140,305
Identifiable assets	21,112,421	4,811,717	25,924,138
Goodwill	—	—	29,776
Total assets	**$ 21,112,421**	**$ 4,811,717**	**$ 25,953,914**
Capital expenditures	$ 5,845	$ 2,503	$ 8,348

	2013		
	Residential	Commercial	Total
REVENUE			
Interest revenue – securitized mortgages	$ 315,512	$ 113,711	$ 429,223
Interest expense – securitized mortgages	(232,626)	(90,610)	(323,236)
Net interest – securitized mortgages	82,886	23,101	105,987
Placement and servicing	241,427	51,692	293,119
Mortgage investment income	34,037	20,129	54,166
	358,350	94,922	453,272
EXPENSES			
Amortization	5,176	2,761	7,937
Interest	26,663	2,507	29,170
Other operating	151,462	31,192	182,654
	183,301	36,460	219,761
Income before income taxes	$ 175,049	$ 58,462	$ 233,511
Identifiable assets	16,282,131	4,257,310	20,539,441
Goodwill	—	—	29,776
Total assets	$ 16,282,131	$ 4,257,310	$ 20,569,217
Capital expenditures	$ 2,400	$ 1,028	$ 3,428

Related Party and Other Transactions

The Company has referred several commercial mezzanine mortgage opportunities to a business controlled by a senior executive and shareholder of the Company. The Company services these mortgages during their terms at market commercial servicing rates. The mortgages which are administered by the Company have a balance of $24,765 as at December 31, 2014 (2013 – $31,245).

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 2014 was $2,494 (2013 – $2,348), 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, 2014, the portfolio had a balance of $8.7 million (2013 – $9.0 million).

In the third quarter of 2014, an entity controlled by a senior executive and shareholder of the Company purchased a 75% interest in a property on which the Company is the lender. The related entity effectively assumed 75% of the mortgage upon the purchase. At December 31, 2014, the mortgage had a principal balance of $17.5 million.

Management compensation

During the year ended December 31, 2014, the Company paid a total annual compensation of $3,757 (2013 – $3,657) 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.

Note 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 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; 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 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 ending on or after December 31, 2017. The Company intends to adopt IFRS 15 in its consolidated financial statements for the annual period beginning on January 1, 2017 and is currently analyzing the impact on the Company's consolidated financial statements.

IAS 1 Amendments – Presentation of Financial Statements

The IAS 1 amendment was issued on December 2014, effective for annual periods beginning on or after January 1, 2016, with earlier application being permitted. The amendment clarifies IAS 1 to address perceived impediments to preparers exercising their judgement in presenting their financial reports. The Company is in process of evaluating the impact of the amendment on the Company's consolidated financial statements.

IFRS 10, 12 and IAS 28 Amendments – Investment Entities: Applying the Consolidation Exception

The amendments were issued on December 18, 2014, addressing issues that have arisen in the context of applying the consolidation exception for investment entities. The Company is in process of evaluating the impact of the amendment on the Company's consolidated financial statements.

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 to 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, 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 recommended 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 follow 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;
- 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 58-101 – *Disclosure of Corporate Governance Practices.*

Committee Members

Peter Copestake (Chair), Duncan Jackman and Barbara Palk

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 and Chief Executive Officer of the Corporation, President of First National and co-founder of First National. Mr. Smith, one of Canada's leading financial services entrepreneurs, has been an innovator in the development and utilization of various securitization techniques to finance mortgage assets. He is Chairman of the Canada Guaranty Mortgage Insurance Company as well as a director of The Empire Life Insurance Company. He is also Vice-Chair of Metrolinx Inc. (GO Transit), a director of the C.D. Howe Institute, a Governor of the Royal Ontario Museum and Chair of Historica Canada. Mr. Smith has a Bachelor of Science (Honours) in electrical engineering from Queen's University and a Master of Science (Economics) from the London School of Economics and Political Science. Mr. Smith is a graduate of the Directors Education Program at the University of Toronto, Rotman School of Management. In 2012, he was awarded The Queen's Diamond Jubilee Medal for contributions to Canada.

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. and Canadian 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, is a member of the Institute of Corporate Directors and holds the designation Chartered Professional Accountant.

Moray Tawse
Is Executive Vice President and Secretary of the Corporation, Executive Vice President of First National and co-founder of First National. Mr. Tawse directs the operations of all of First National's commercial mortgage origination activities. With over 30 years of experience in the real estate finance industry, Mr. Tawse 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. In addition, Mr. Tawse is also an independent director of Regal Lifestyle Communities Inc., a TSX listed company that owns and operates retirement properties across Canada.

Peter Copestake
Serves as the Executive in Residence at the Queen's University School of Business and as a corporate director and business consultant. Over the past 30 years he has held senior financial and executive management positions at federally regulated financial institutions and in the federal government. Other current directorships include membership on the Finance and Pension committees of Queen's University and directorships at Royal and Sun Alliance Insurance Company of Canada and Canadian Derivatives Clearing Corporation. He additionally serves on the Independent Review Committees at First Trust Portfolios Canada and at PIMCO Canada and as Chair of the South East Ontario Medical and Academic Organization.

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 also 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. Mr. Jackman sits on a number of public and private company boards. Prior to 2001, 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 from McGill University.

Barbara Palk

Retired as President of TD Asset Management Inc. in 2010 following a 30 year career in institutional investment and investment management. She currently serves on the Boards of TD Asset Management USA Funds Inc. in New York, Ontario Teachers' Pension Plan and Queen's University where she is Chair. Her previous board experience includes the Canadian Coalition for Good Governance, whose Governance Committee she chaired, Greenwood College School, the Investment Counselling Association of Canada, the Perimeter Institute, the Shaw Festival and UNICEF Canada. Ms. Palk is a member of the Institute of Corporate Directors, a Fellow of the Canadian Securities Institute and a CFA charterholder. She holds a Bachelor of Arts (Honours, Economics) degree from Queen's University, and has been named one of Canada's Top 100 Most Powerful Women (2004).

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 of, and chairs, the audit committee for Discovery Parks Holdings Ltd., and serves as a 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 an MBA from the University of Western Ontario, a Bachelor of Commerce (Finance) from the University of Calgary, and is a CFA charterholder.

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

Annual Meeting

May 6, 2015, 10 a.m. EDT
TMX Broadcast Centre
The Gallery
The Exchange Tower
130 King Street West
Toronto, Ontario

Senior Executives of First National Financial LP

Stephen Smith
Co-founder, Chairman and
Chief Executive Officer

Moray Tawse
Co-founder and Executive Vice President

Robert Inglis
Chief Financial Officer

Scott McKenzie
Senior Vice President, Residential Mortgages

Jeremy Wedgbury
Senior Vice President, Commercial Mortgages

Lisa White
Vice President, Mortgage Administration

Hilda Wong
Vice President and General Counsel

Jason Ellis
Managing Director, Capital Markets

Rick Votano
Vice President, Information Technology

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

Ernie Stapleton
President, Fundamental
ernie@fundamental.ca

Investor Relations Website

www.firstnational.ca

Registrar And Transfer Agent

Computershare Investor Services Inc.,
Toronto, Ontario
1.800.564.6253

Exchange Listing And Symbols

Common shares: (TSX) FN
Preferred shares: (TSX) FN.PR.A

VANCOUVER CALGARY TORONTO MONTREAL HALIFAX