ANNUAL REPORT 2019

FIRST NATIONAL

FINANCIAL CORPORATION


2020
VISION
AND BEYOND

CORPORATE PROFILE

First National Financial is Canada's largest non-bank lender, originating and servicing both residential and commercial mortgages since 1988. Our broad range of mortgage solutions and unwavering commitment to innovative customer service has made First National a preferred choice for hundreds of thousands of borrowers and independent mortgage brokers from coast to coast. Our common shares trade on the Toronto Stock Exchange under the symbol FN, and our preferred shares trade under the symbols FN.PR.A and FN.PR.B. Shareholders can find more information about our people and markets at www.firstnational.ca.

A RECORD YEAR

300,000+

Borrowers served by First National in 2019 across Canada.

$111.4 Billion

Mortgages under administration (MUA) – the source of most of the Company's earnings – reached this all-time record at year end 2019, a 5% increase over 2018.

$1.3 Billion

Revenue in 2019 grew 12% to a new annual record, reflecting growth in mortgage origination and higher MUA.

$177.2 Million

Record net income in 2019 ($2.90 per share) reflected good execution, wider mortgage spreads and more placement with institutional investors.

40%

The after-tax, Pre-Fair Market Value[1] return on shareholders' equity in 2019 demonstrated the efficiency of the First National business model.

$144.4 Million

Value of common share dividends declared in 2019, bringing the cumulative total to $1.4 billion ($23.32 per share) since the Company's initial public offering (IPO) in 2006.

514%

Total shareholder return between the IPO date in 2006 and December 31, 2019.

[1] Non-IFRS measure. See MD&A for more details.

OUR LEADERSHIP TEAM

STEPHEN SMITH
Co-founder, Chairman and
Chief Executive Officer

MORAY TAWSE
Co-founder and
Executive Vice President

JASON ELLIS
President and
Chief Operating Officer

ROBERT INGLIS
Chief Financial Officer

SCOTT MCKENZIE
Senior Vice President,
Residential Mortgages

JEREMY WEDGBURY
Senior Vice President,
Commercial Mortgages

HILDA WONG
Senior Vice President and
General Counsel

MESSAGE TO SHAREHOLDERS

Fellow Shareholders:

First National is a different kind of financial institution.

We are not a bank and do not accept deposits, and yet we are one of Canada's largest lenders, with prime mortgages accounting for about 94% of our $111.4 billion portfolio of mortgages under administration.

We have a thousand employees, making us small in comparison to the Big Six banks, and yet we originated and renewed $28.4 billion of mortgages in 2019.

We do not have storefronts, and yet the First National name is trusted by hundreds of thousands of borrowers from coast to coast.

We are not a "fintech," and yet our proprietary MERLIN underwriting system is likely the leading technology in the mortgage broker distribution channel.

These differences make a difference to long-term shareholder value creation.

Over the eight years since the Company converted to a corporation from an income trust:

- Revenue grew at an average annual rate of 14%, and in 2019 surpassed $1.3 billion;
- Net income grew at an average annual rate of 12% to settle at a record $177.2 million, or $2.90 per common share, in 2019;
- Dividends grew every year, from $1.25 per common share to $1.90 per common share, excluding special dividends paid in each of the past three years; and
- After-tax Pre-Fair Market Value[1] return on shareholders' equity averaged 43%.

We are proud of this track record and of the business model used to create value. Established in 1988, it has proven to be both efficient and effective through the natural ebb and flow of economic and housing market cycles.

A DIFFERENT BUSINESS MODEL

At its core, the business model focuses on funding the Company's origination activities through a variety of sources – including its own balance sheet – and earning stable and recurring income from servicing these mortgages.

Since 2015, we have complemented this business model through the development of a third-party underwriting and servicing business, where First National adjudicates mortgages originated by other Canadian institutions and underwrites them in accordance with customer guidelines.

This is a textbook definition of what we do, but leaves out two very important drivers of performance: First National's industry partners and our team.

[1] Non-IFRS measure. See MD&A for more details.

"First National is committed
to the highest standards of integrity,
transparency, compliance
and discipline."

A DIFFERENT APPROACH

Our partners include independent mortgage brokers who provide borrowers with insightful advice in selecting a mortgage product. When brokers recommend First National, it's because we offer the best combination of service, value and convenience. Our partners also include some of the country's largest insurance companies, banks and wealth management firms. When these institutions want to invest in mortgages in a risk-managed fashion, they come to First National because they value our expertise in evaluating borrowers and structuring, pricing and servicing loans from beginning to end.

I'm pleased to say that our partnerships have never been stronger as a result of the efforts of the First National team. Up and down the line, employees care deeply about the work they do and how they do it. To borrowers, brokers and funding partners, the people of First National are imaginative problem solvers who know how to get the right deal done in the right time frame.

If there is just one difference that has made First National a success story – and makes us optimistic about the future – it is our workforce. This past year, we continued to see evidence every day of employees building meaningful relationships with our external stakeholders and business partners, despite the high volume of transactions processed.

It is not easy to create a culture like First National's. We believe a flat organizational structure, careful recruitment, thorough onboarding, and bias for promoting from within have contributed greatly to workplace engagement and morale. Our Company is not too old to remember its entrepreneurial roots. In the earliest days after First National was founded, there were no complex computer systems or policy manuals: there was only hard work and creativity. Those two qualities and our integrity remain central to First National's long-term success.

2019 HIGHLIGHTS

The past year was a productive one. Both single-family residential and commercial segments of First National posted record originations. Our business model capitalized on a strong national economy and low interest rates to deliver these results.

For single-family, growth reflected First National's standing in the mortgage broker channel. Growth was achieved in all regions, led by Ontario and the Maritimes, with combined volumes 17% ahead of 2018. The majority of the mortgages we underwrote in 2019 were prime, but we also found good success with our Excalibur-branded mortgage program. Excalibur features expanded underwriting criteria designed to serve self-employed and other credit-worthy borrowers who fall just outside traditional guidelines. Although Excalibur is only available to our Ontario broker partners, volumes were healthy and the growth rate exceeded 40%.

For commercial, growth was driven by demand for CMHC-insured mortgages, as well as conventional and bridge mortgages. The commercial team was very active in serving owners of apartment, self-storage and retirement-home properties. These property types are benefiting from population growth, aging demographics, and the need for multi-unit apartment rental stock in many urban markets. Always popular with young Canadians, rentals are also attracting more retirees for lifestyle and financial reasons. As a result of downsizing, demand for self-storage units has increased. First National is well prepared to meet these needs with financing at every project stage – land acquisition, construction, term and property repositioning.

Our third-party underwriting business also contributed to First National's growth, as our long-standing customer continued to excel in the broker channel.

In December 2019, we expanded this arm of First National by providing underwriting and fulfilment processing services for mortgages originated by Manulife Bank of Canada through the residential mortgage broker channel in Ontario and Atlantic Canada. This is an important agreement that leverages the capabilities and strengths of both parties. To deliver our services, First National developed and deployed customized software based on MERLIN technology to accept mortgage applications, recruited a skilled team in Toronto and immersed ourselves in Manulife Bank's credit policies, compliance standards and controls. In turn, Manulife Bank funds all mortgages and retains full responsibility for underwriting guidelines, mortgage servicing and the client relationship.

We were very pleased to be chosen for this mandate. It is an endorsement of First National and the mortgage broker channel. Reports show that mortgage brokers account for almost $100 billion of new mortgage originations each year. When leading institutions like this engage in the channel, it provides brokers and borrowers with more choices.

With respect to our balance sheet, 2019 was a productive year. In November, the Company issued $200 million of senior unsecured notes. The notes bear interest at 3.582%, payable in equal semi-annual amounts starting in May this year. Institutional participation in the offering was strong, and we achieved a credit spread of 2.1% over the benchmark bond. This made the offering our most successful debt deal to date.

SUCCESSION PLANNING

Following a successful transition into the role of Chief Operating Officer in October 2018, Jason Ellis added the title of President of First National in November 2019.

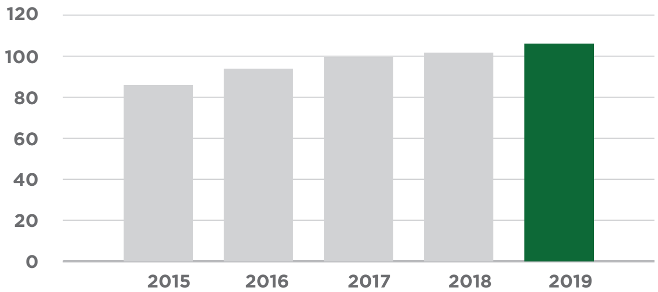
We were delighted to make this appointment. Jason is a 16-year First National veteran who successfully led the Company's Treasury and Capital Markets activities in his previous role as Senior Vice President and Managing Director, Capital Markets. He managed the majority of the Company's relationships with its funding partners before assuming his new responsibilities.

Jason is an integral part of First National's success, bringing new ideas and energy to our deliberations, and will maintain our focus on operational excellence. I have no doubt he will also continue to champion the entrepreneurial culture upon which the Company was founded. As noted above, we believe in promoting from within, as it strengthens our business and ensures long-term continuity of our culture. This is the latest and highest-profile example.

Also in the fourth quarter, Moray Tawse and I sold some of our shares. Even with the sale, we control about 71% of the outstanding common shares of First National, meaning we have full alignment with all public shareholders as we perform our ongoing leadership duties. We are committed, engaged and enthusiastic about First National and look forward to participating in its future.

MORTGAGES UNDER ADMINISTRATION
($ Billions)

5%
5-year compound annual growth

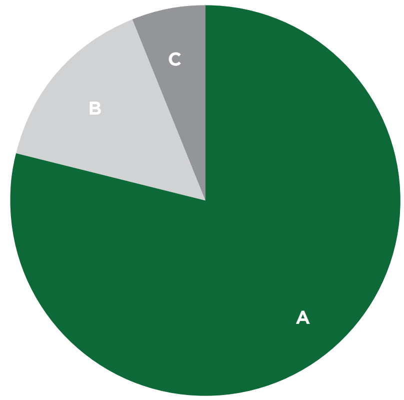


MUA BY ASSET TYPE

A
78%
Insured

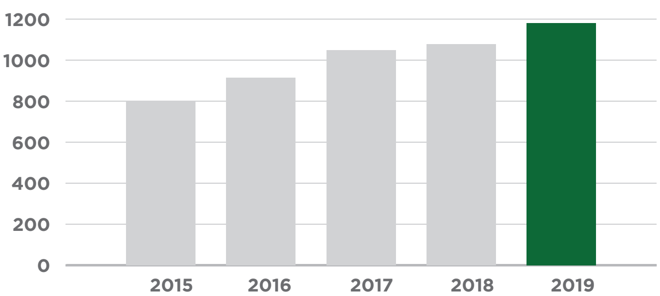
B
16%
Uninsured single-family residential

C
6%
Uninsured multi-residential and commercial



REVENUE
($ Millions)

11%
5-year compound annual growth



2019 REVENUE SOURCES PRIOR TO FAIR VALUE GAINS/LOSSES

A
37%
Institutional placements

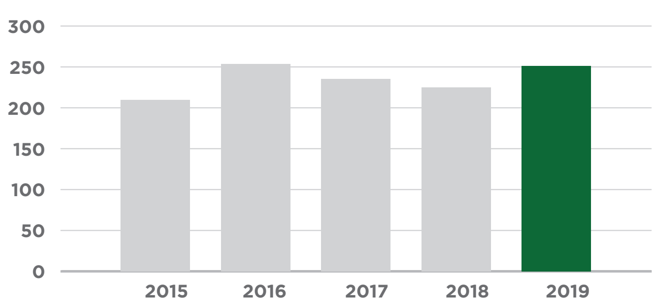
B
23%
Net interest – securitized mortgages

C
26%
Mortgage servicing

D
14%
Investment income

PRE-FAIR MARKET VALUE EBITDA[1]
($ Millions)

7%
5-year compound annual growth



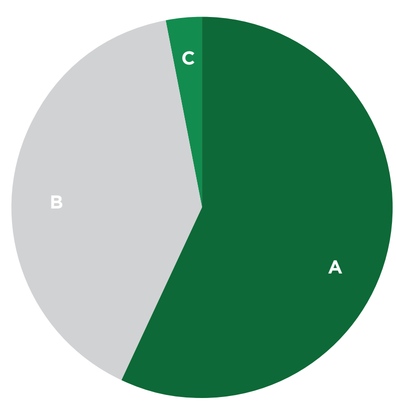
[1]Non-IFRS measure. See MD&A for more details.

2019 FUNDING SOURCES

A
65%
Institutional investors

B
31%
Securitization

C
4%
Internal



THE MARKETPLACE

This past year was a quiet period for government policy interventions in the housing market, as changes implemented from 2016 through 2018 were left to do their work to curb risk and, in some markets, end speculation. To my mind, it seems the policymakers are content with the impact of these measures. However, if there are future changes, First National has shown its adaptability – particularly with revised B-20 guidelines – and will remain quick to adapt.

LOOKING FORWARD

At the time of writing, two of First National's leading indicators look promising. Single-family mortgage commitments have significantly outpaced the levels we saw at this time last year. In commercial, borrowers continue to have a good appetite for product and, consequently, our commercial team anticipates a strong start to 2020.

That said, we will continue to face uncertain securitization margins. Mortgage spreads tightened toward the end of 2019 and have not widened so far in 2020. The effect of pre-2018 fair-value accounting conventions will continue to have a negative impact on income in 2020, albeit at a slightly lower level than in 2019.

As always, the economy and employment levels will dictate final outcomes

2020 AGENDA

First National operates with a continuous improvement mindset: this extends from our technology foundation to our customer service levels. In 2020, we will refine our technology infrastructure to improve the interactions we have with stakeholders. This will include enhancing MERLIN through ongoing software updates.

Of course, a lender must have great technology and great execution, so we will encourage our team to strive for ever faster and better service levels. As part of standard operating practice, we will conduct biannual employee surveys and pay close attention to the results to ensure First National people remain highly engaged and well prepared to meet new challenges and unlock new opportunities.

While seeking new customers, we will also strive to secure every mortgage renewal. In 2020, as in years past, realizing the value inherent in our single-family renewal book is a top priority.

THANKS

First National is a different kind of company. While we are proud to be listed on the TSX and grateful for the confidence expressed by our public shareholders, we run this business by thinking first about our customers. With satisfied customers, all things are possible.

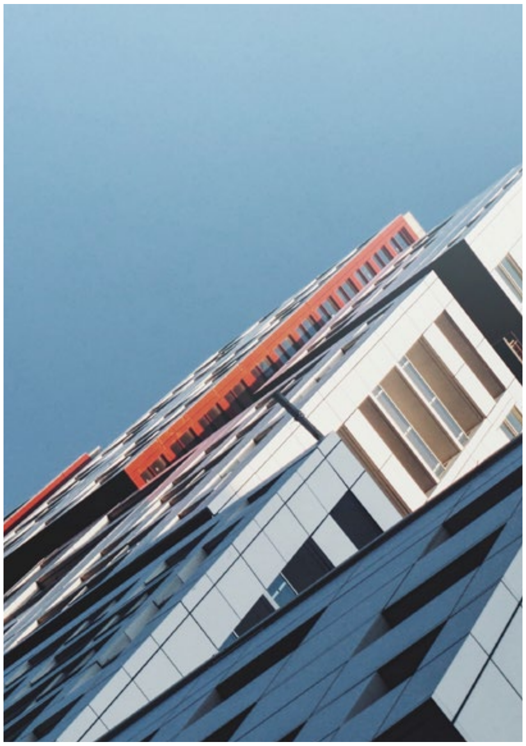
On behalf of the Board and our senior leaders, I express my deep gratitude to our customers, including our business partners, as well as to our shareholders. I also offer my sincere appreciation to First National employees for their tremendous efforts. Their character and capabilities make the difference.

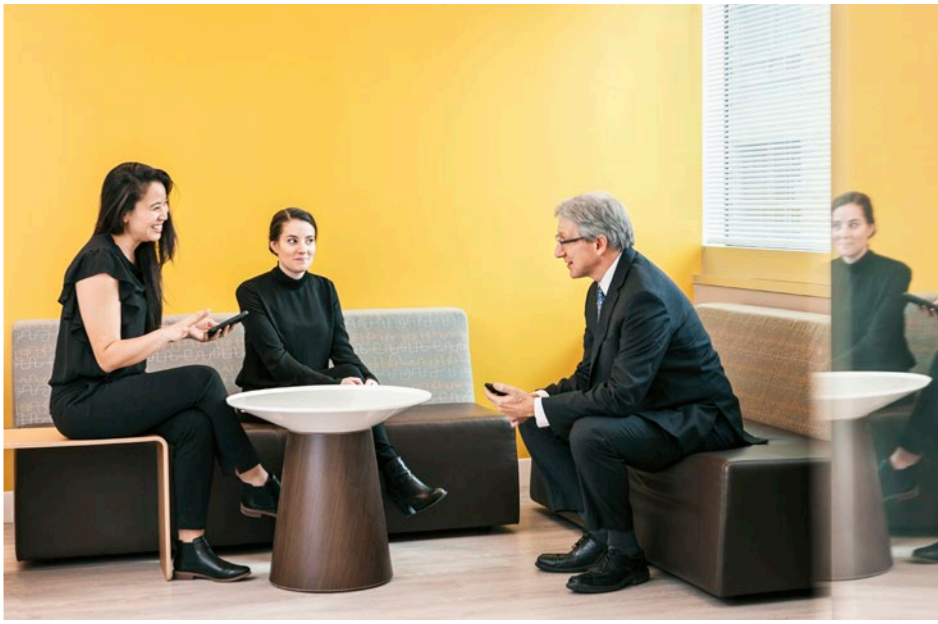
Yours sincerely,

Stephen Smith
Chairman and Chief Executive Officer

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, 2020. This discussion should be read in conjunction with the audited consolidated financial statements and accompanying notes of First National Financial Corporation (the "Company" or "Corporation" or "First National") as at and for the year ended December 31, 2019. The audited consolidated financial statements of the Company have been prepared in accordance with International Financial Reporting Standards ("IFRS").





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

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

Additional information relating to the 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 over $111 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.

2019 RESULTS SUMMARY

Management is very pleased with the results of 2019. After a slow start to the year, single-family origination increased 11% year over year, and the commercial segment produced record origination volumes, which increased 19% over 2018. On a consolidated basis, total new origination was higher by 13% compared to 2018. Higher volume had a favourable impact as normalized earnings grew 12%.

- MUA grew to $111.4 billion at December 31, 2019, from $106.2 billion at December 31, 2018, an increase of 5%; the growth from September 30, 2019, when MUA was $110.6 billion, was 3% on an annualized basis.
- Total new single-family mortgage origination was $13.5 billion in 2019 compared to $12.2 billion in 2018, an increase of 11%. The Company attributes this to a strong economy, lower mortgage rates and First National's market share in the mortgage broker channel. Commercial segment origination of $7.4 billion was 19% more than the $6.2 billion originated in 2018. Overall new origination increased by 13% in 2019 compared to 2018.

- The Company took advantage of opportunities in the year to renew $5.5 billion of single-family mortgages ($6.1 billion a year ago). For the commercial segment, renewals increased to $2.0 billion from $1.3 billion.
- Revenue for 2019 increased by 12% to $1.3 billion from $1.2 billion in 2018. The increase reflected the growth in mortgage origination in the year and a change in the funding mix, which featured more placement with institutional investors as opposed to securitization. The volume of origination for institutions increased by 24% compared to 2018, which contributed to an increase of $63.6 million in placement fee revenue. In addition, the comparatively higher interest rate environment, which began in mid-2017, had an impact. Because of higher interest rates in recent years, mortgages added to the portfolio of securitized mortgages in those years have higher interest rates than the average rates of the mortgages maturing in the securitized portfolio. Interest revenue on securitized mortgages increased by $87.5 million between the years.
- Income before income taxes increased to $241.7 million in 2019 from $227.4 million in 2018. The increase was the result of strong mortgage origination, wider mortgage spreads in 2019, and a shift in funding from securitization to institutional placement. The pace of growth was affected by changing capital market conditions. In aggregate, the impact from financial instruments decreased pre-tax income by $12.5 million, comparing 2019 to 2018.
- The Company's earnings before income taxes, depreciation and amortization, and gains and losses on financial instruments ("Pre-FMV EBITDA") for 2019 increased by 12% to $251.3 million from $225.2 million in 2018. The increase is the result of increased origination, but also of the Company's decision to shift its funding from securitization to institutional placement. By placing mortgages with institutions, most of the economics of the transaction are recognized in the current period. Using securitization funding, the value inherent in the mortgages is realized over the term of the mortgages – typically five years. By increasing funding through institutional placement by approximately $1.3 billion as opposed to securitization, First National has accelerated the recognition of earnings into the current period. The Company has also benefited from comparatively wider mortgage spreads, which prevailed for most of 2019.

The Company's Board of Directors increased the regular monthly dividend from $1.90 to $1.95 per common share on an annualized basis effective with the dividend paid on December 16, 2019, and declared a special common share dividend in the amount of $0.50 per share, which was also paid on December 16, 2019. The special dividend reflects the Board's determination that the Company has generated excess capital in the past year and that the capital needed for near-term growth can be generated from current operations.

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
2019					
Fourth quarter	**$342,138**	**$48,993**	**$61,766**	**$0.80**	**$37,685,593**
Third quarter	**$362,833**	**$60,578**	**$80,772**	**$1.00**	**$37,249,143**
Second quarter	**$335,241**	**$44,164**	**$68,522**	**$0.72**	**$37,229,876**
First quarter	**$286,311**	**$23,478**	**$40,225**	**$0.38**	**$36,193,793**
2018					
Fourth quarter	$312,039	$32,220	$55,780	$0.53	$36,037,127
Third quarter	$321,835	$51,958	$62,989	$0.85	$35,597,827
Second quarter	$290,935	$46,347	$56,048	$0.76	$35,794,066
First quarter	$256,701	$35,902	$50,368	$0.59	$33,846,283

[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 (except those on mortgage investments) and deducting gains on the valuation of financial instruments.

With First National's large portfolio of mortgages pledged under securitization, quarterly revenue is driven primarily by the gross interest earned on the mortgages pledged under securitization. The gross interest on the mortgage portfolio is dependent both on the size of the portfolio of mortgages pledged under securitization, as well as mortgage rates. Because mortgage rates and MUA have both increased, revenue has also increased. Net income is partially dependent on conditions in bond 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 Company's core business. By removing this volatility and analyzing Pre-FMV EBITDA, management believes a more appropriate measurement of the Company's performance can be assessed.

In the past eight quarters, the Company has experienced a relatively volatile economic environment. In most of 2018, the economic outlook was positive and there was a surplus of liquidity for investment in financial assets. This bred a very competitive marketplace such that mortgage funding spreads tightened to levels not seen since 2007. This reduced the profitability of the Company's operations. However, toward the end of 2018, economic worries resurfaced, and interest rates fell. Mortgage lenders pulled back and mortgage spreads widened by about 0.30%. This had a significant positive effect on the value of the Company's operations. This trend is evident in the Pre-FMV EBITDA figures above. In the first quarter of 2019, Pre-FMV EBITDA was at its lowest in the two-year period, as tighter spread 2018 originated mortgages were securitized and placed. Combined with lower origination volumes typically experienced in the first quarter of each year, profitability was low. This trend reversed in the second quarter of 2019, as the Company was able to take advantage of wider mortgage spreads and increased profitability. In the third quarter of 2019, the Company shifted its mortgage funding strategy to use more institutional placements instead of securitization, which accelerated the recognition of the value inherent in the mortgages originated, leading to the large increase in earnings in the quarter.

OUTSTANDING SECURITIES OF THE CORPORATION

At December 31, 2019, and February 24, 2020, the Corporation had 59,967,429 common shares; 2,887,147 Class A preference shares, Series 1; 1,112,853 Class A preference shares, Series 2; 175,000 April 2020 senior unsecured notes; and 200,000 November 2024 senior unsecured notes outstanding.

SELECTED ANNUAL FINANCIAL INFORMATION AND RECONCILIATION TO PRE-FMV EBITDA[1]

($000s, except per share amounts)

	2019	2018	2017
For the year ended December 31, INCOME STATEMENT HIGHLIGHTS			
Revenue	**1,326,523**	1,181,510	1,078,768
Interest expense – securitized mortgages	**(739,071)**	(646,069)	(511,939)
Brokerage fees	**(102,596)**	(75,354)	(83,260)
Salaries, interest and other operating expenses	**(238,926)**	(227,739)	(193,032)
Add (deduct): realized and unrealized losses (gains) on financial instruments	**9,655**	(3,162)	(56,259)
Deduct: unrealized losses regarding mortgage investments	**(4,300)**	(4,000)	—
Pre-FMV EBITDA[1]	**251,285**	225,186	234,278
Amortization of intangible and capital assets	**(4,217)**	(4,931)	(5,135)
Add: realized and unrealized gains on financial instruments excluding those on mortgage investments	**(5,355)**	7,162	56,259
Provision for income taxes	**(64,500)**	(60,990)	(75,750)
Net income	**177,213**	166,427	209,652
Common share dividends declared	**144,421**	171,407	184,400
PER SHARE HIGHLIGHTS			
Net income per common share	**2.90**	2.73	3.42
Dividends per common share	**2.41**	2.86	3.08
At year end BALANCE SHEET HIGHLIGHTS			
Total assets	**$37,685,593**	$36,037,127	$32,776,278
Total long-term financial liabilities	**$374,025**	$174,829	$174,693

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 the residential and commercial mortgage markets 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. 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 for Canadian single-family and commercial customers; growing assets under administration; employing technology to enhance service to mortgage brokers and borrowers, 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. The Company is considered 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;
- Raising capital for operations; 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 rights, renewals and the growth of the customer base for marketing initiatives. As at December 31, 2019, MUA totalled $111.4 billion, up from $106.2 billion at December 31, 2018, an increase of 5%. The growth of MUA in the fourth quarter of 2019 from September 30, 2019, on an annualized basis was 3%.

GROWTH IN ORIGINATION OF MORTGAGES

Direct Origination by the Company

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. Increased origination satisfies demand from its institutional customers and produces volume for the Company's own securitization programs. In 2019, the Company's single-family origination increased across most of the country. The Company believes this is the result of a strong economy coupled with lower mortgage rates and First National's market share in the mortgage broker distribution channel. All of the Company's sales offices experienced growth: Toronto (17%), Vancouver (1%), Calgary (2%) and Montreal (6%). In aggregate, the Company's single-family origination grew by 11% in 2019. The commercial segment had a record year in 2019, increasing volume by 19% to $7.4 billion in 2019 compared to $6.2 billion in 2018. Together, overall new origination for 2019 increased 13% year over year.

Third-Party Mortgage Underwriting and Fulfilment Processing Services

In 2015, the Company launched its third-party underwriting and fulfilment processing services business with a large Canadian schedule I bank ("Bank"). The business is designed to adjudicate mortgages originated by the Bank through the single-family residential mortgage broker channel. First National employs 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 funds all the mortgages underwritten under the agreement and retains full responsibility for mortgage servicing and the client relationship. 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. In late 2019, the Company entered into a similar agreement with another Canadian bank.

Relaunch of Excalibur Mortgage Products

In April 2018, the Company relaunched its alternative single-family ("Excalibur") mortgage products. Alternative lending describes single-family residential mortgages that are originated using broader underwriting criteria than those applied in originating prime mortgages. Alternative borrowers are generally considered "A" quality borrowers in terms of their credit histories, but do not qualify for a prime mortgage because of non-conformities, such as the degree of income disclosure and verification required. The Excalibur program also includes a product for borrowers with recently remediated credit. These mortgages generally have higher interest rates than prime mortgages. Although the Company's original alternative program was discontinued in 2008 as a result of the credit crisis, First National's relationships with mortgage brokers and underwriting systems allowed it to seamlessly relaunch the product in the spring of 2018. The product has been originated primarily for placement with institutional investors, but beginning in April 2019, the Company finalized an agreement with a bank-sponsored securitization conduit to fund a portion of the Excalibur origination. The Excalibur relaunch was rolled out gradually, beginning in Ontario. Currently the program is open to include all Ontario brokers, with a potential expansion to western Canada later in 2020.

RAISING CAPITAL FOR OPERATIONS

Bank Credit Facility

The Company has a revolving line of credit with a syndicate of banks of $1.25 billion. This facility enables the Company to fund the large amounts of mortgages accumulated for securitization. In the second quarter of 2019, the Company extended the term of the facility by one year such that the maturity is now March 2024. The facility bears interest at floating rates. The Company has elected to undertake this debt for a number of reasons: (1) the facility provides the amount of debt required 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 senior unsecured notes, which are fully drawn during their term; (3) the five-year remaining term gives the Company a committed facility for the medium term; and (4) the cost of borrowing reflects the Company's BBB issuer rating.

Note Issuance

On November 25, 2019, the Company issued 200,000 3.582% Series 2 senior unsecured notes for a five-year term pursuant to a private placement under an offering memorandum. The net proceeds of the offering, after broker commissions, of $199.3 million were loaned to FNFLP. On settlement, the proceeds were used to pay down a portion of the indebtedness under the bank credit facility. The Company plans to draw on the bank credit facility to repay the existing 4.01% $175 million Series 1 note when it matures in April 2020. Effectively the new note issuance has increased the Company's leverage by $25 million, as $175 million has been earmarked for paying off the older note on maturity.

Preferred Share Issuance

Effective April 1, 2016, the Company reset the dividend rate on the 2,887,147 Class A Series 1 preference shares issued in 2011 that did not elect to convert to Class A Series 2 preference shares. The Series 1 shares provide an annual dividend rate of 2.79%. Also, effective April 1, 2016, 1,112,853 Class A Series 2 were issued on the conversion from Series 1 shares. These bear a floating rate dividend calculated quarterly based on the 90-day T-Bill rate. Both the Series 1 and Series 2 shares pay quarterly dividends, subject to Board of Director approval, and are redeemable at the discretion of the Company such that after the five-year term ending on March 31, 2021, the Company can choose to extend the shares for another five-year term at a fixed spread (2.07%) over the relevant index (five-year Government of Canada bond yield for any Series 1 shares or the 90-day T-Bill rate for any Series 2 shares). While the investors in these shares have an option on each five-year anniversary to convert their Series 1 preference shares into Series 2 preference shares (or vice versa), there is no provision of redemption rights to these shareholders. As such, the Company considers these shares to represent a permanent source of capital.

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 served as an issuer and administrator of NHA-MBS since 1995. 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 Canada Mortgage Bonds ("CMB") program. Issuer status provides the Company with direct and independent access to reliable and low-cost funding.

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%
2009–2016	1.77%
2017–2018	1.36%
2019	1.42%

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 2013, liquidity issues at financial institutions diminished and the competition for mortgages increased such that spreads remained consistently higher than pre-crisis levels. In 2014, more competitive pressures took mortgage rates lower and compressed mortgage spreads to 2007 levels; however, in 2015, mortgage spreads quickly widened as a slowdown in economic growth and the Bank of Canada rate cut reduced bond yields dramatically. This trend continued into 2016, as optimism about the economy was mixed such that spreads remained at levels in excess of 1.8%. In 2017 and 2018, economic information was favourable, and competition was strong such that spreads were the tightest seen in the past decade, falling to 1.10% in the third quarter of 2018. With renewed worries about global economics, interest rates on government debt decreased rapidly at the end of 2018 and the first quarter of 2019. Despite the lower funding rates in the first quarter of 2019, mortgage rates did not fall, as lenders delayed reducing profit margins in an unsettled economy. With competitive pressures in the second and third quarter of 2019, spreads tightened but remained relatively wider than spreads in 2018. In 2019, the Company originated and renewed for securitization purposes approximately $7.2 billion of single-family mortgages and $1.7 billion of multi-unit residential mortgages. In 2019, the Company securitized through NHA-MBS approximately $6.6 billion of single-family mortgages and $0.9 billion of multi-unit residential mortgages.

In August 2013, CMHC announced that it would be limiting the amount of guarantees it would provide 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. 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 maximum amount allocated under the process has exceeded First National's requirements in every quarter since inception. The process was amended in July 2016 to combine both NHA-MBS pools for sale to the market and to CHT under one allocation. The available guarantees to be allocated were increased to accommodate issuance to CHT and continue to exceed the Company's current needs. CMHC also modified the tiered NHA-MBS guarantee fee pricing structure, increasing the issuance threshold for increased fees to $9.0 billion. The tiered limit of $9.0 billion remains unchanged for 2020. On December 31, 2019, CMHC announced that for NHA-MBS pools issued after July 1, 2020, guarantee fees will be increased. The Company estimates that the increase translates to an additional annual cost of funding of 0.05% per year for its NHA-MBS program.

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. The ability to sell into the CMB has given the Company access to lower costs of funds on both single-family and multi-family mortgage securitizations. Because of the effectiveness of the CMB, many institutions have indicated their desire to participate. As a result, CHT 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. In 2019, the Company, through its subsidiary First National Asset Management Inc. ("FNAM"), also took advantage of funding provided by the CMB, issuing 12 NHA-MBS pools totalling $131 million and securitizing those pools in the CMB program.

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 with the exception of any losses related to mortgage investments ("Pre-FMV EBITDA"[1]); and
- Dividend payout ratio.

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. 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.

	QUARTER ENDED		YEAR ENDED	
($000s)	December 31, 2019	December 31, 2018	December 31, 2019	December 31, 2018
FOR THE PERIOD				
Revenue	**342,138**	312,039	**1,326,523**	1,181,510
Income before income taxes	**66,593**	44,050	**241,713**	227,417
Pre-FMV EBITDA[1]	**61,766**	55,780	**251,285**	225,186
AT PERIOD END				
Total assets	**37,685,593**	36,038,527	**37,685,593**	36,038,527
Mortgages under administration	**111,378,891**	106,151,363	**111,378,891**	106,151,363

Note:
[1] This non-IFRS measure adjusts income before income taxes by adding back expenses for depreciation of capital assets, but it also eliminates the impact of changes in fair value by adding back losses on the valuation of financial instruments (except those on mortgage investments) used in and deducting gains on the valuation of financial instruments.

Since going public in 2006, First National has been considered a high-yielding dividend paying company. With a large MUA that generates continuing income and cash flow and a business model that is designed to make efficient use of capital, the Company has been able to pay distributions to its shareholders that 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 paid out as dividends. Similar to the performance measurement for earnings, the Company also calculates the dividend payout ratio on a basis using after-tax Pre-FMV EBITDA.

Determination of Common Share Dividend Payout Ratio

	QUARTER ENDED		YEAR ENDED	
($000s)	December 31, 2019	December 31, 2018	December 31, 2019	December 31, 2018
FOR THE PERIOD				
Net income attributable to common shareholders	**48,230**	31,465	**174,156**	163,499
Total dividends paid or declared on common shares	**58,968**	88,202	**144,421**	171,407
Dividends paid or declared on common shares, excluding special dividend	**28,984**	28,235	**114,437**	111,440
Total common share dividend payout ratio	**122%**	280%	**83%**	105%
Regular common share dividend payout ratio(1)	**60%**	90%	**66%**	68%
After-tax Pre-FMV dividend payout ratio(2)	**66%**	72%	**64%**	70%

Note:
(1) This ratio is calculated by excluding the payment of the special dividends declared at the end of each year.
(2) This non-IFRS measure adjusts the net income used in the calculation of the "Regular common share 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 (except those on mortgage investments) and deducting gains on the valuation of financial instruments. The Company uses its aggregate effective tax rate to tax affect the impact of the valuation of financial instruments on this ratio.

For the year ended December 31, 2019, the common share payout ratio was 83% compared to 105% in 2018. However, in November of both 2019 and 2018, the Company declared a special dividend, which represented the distribution of excess retained earnings not required for Company growth initiatives. Including such dividends distorts the payout ratios. If the special dividends are excluded from the calculation, the payout ratios would have been 66% in 2019 and 68% in 2018. In both 2019 and 2018, the Company recorded gains and losses on account of the changes in fair value of financial instruments. The gains and losses are recorded in the period in which the prices on Government of Canada bond yields change; however, the offsetting economic impact is largely to be reflected in narrower/wider spreads in the future from the mortgages pledged for securitization. Accordingly, management does not consider this revenue to be available for dividend payment. If the gains and losses on financial instruments in the two years are excluded from the above calculations, the dividend payout ratio for 2019 would have been 64% compared to 70% in 2018.

The Company also paid $3.1 million of dividends on its preferred shares in 2019 compared to $2.9 million in 2018.

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 the mortgages it originates, which provide the Company with servicing fees to complement revenue earned through originations. For the year ended December 31, 2019, new origination volume increased from $18.5 billion to $21.0 billion, or about 13%, compared to 2018.

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 $28.5 billion of new originations and renewals in 2019, $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 placed. 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 $28.5 billion of new originations and renewals in 2019, $18.6 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.

The Company provides underwriting and fulfilment processing services to a mortgage originator using the mortgage broker distribution channel. The Company earns a fee based on the dollar value of funded mortgages. These fees are recognized at the time a mortgage funds and are included in “mortgage servicing income” in the consolidated statement of income.

RESULTS OF OPERATIONS

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

	QUARTER ENDED		YEAR ENDED	
($ millions)	December 31, 2019	December 31, 2018	December 31, 2019	December 31, 2018
MORTGAGE ORIGINATIONS BY SEGMENT				
New single-family residential	**3,624**	2,760	**13,523**	12,231
New multi-unit and commercial	**2,226**	1,848	**7,431**	6,237
Sub-total	**5,850**	4,608	**20,954**	18,468
Single-family residential renewals	**1,409**	1,322	**5,504**	6,083
Multi-unit and commercial renewals	**603**	592	**1,996**	1,338
Total origination and renewals	**$7,862**	$6,522	**$28,454**	$25,889
MORTGAGE ORIGINATIONS BY FUNDING SOURCE				
Institutional investors – new residential	**2,140**	2,446	**8,223**	6,495
Institutional investors – renew residential	**201**	628	**3,204**	2,490
Institutional investors – multi/commercial	**1,994**	1,873	**7,153**	5,957
NHA-MBS/CMB/ABCP securitization	**3,185**	1,359	**8,887**	10,109
Internal Company resources/CMBS	**342**	216	**987**	838
Total	**$7,862**	$6,522	**$28,454**	$25,889
MORTGAGES UNDER ADMINISTRATION				
Single-family residential	**80,709**	79,166	**80,709**	79,166
Multi-unit residential and commercial	**30,670**	26,985	**30,670**	26,985
Total	**$111,379**	$106,151	**$111,379**	$106,151

Total new mortgage origination volumes increased in 2019 compared to 2018 by 13%. Single-family volumes increased by 11% and commercial segment volumes increased by 19% year over year. Management believes the increase in the single-family segment is due to a strong economy coupled with low mortgage rates and the Company's position in the mortgage broker distribution channel. With lower risk-free interest rates, mortgage rates offered by the Company have decreased since December 31, 2018. Accordingly, despite new stress tests implemented as part of revised B-20 guidelines effective in 2019, lower mortgage rates make it comparatively easier for borrowers to qualify for similar mortgage amounts between the years. The Company believes that its strong market share in the mortgage broker channel has also led to increased origination. All the Company's regional offices experienced growth, particularly in Ontario and the Maritimes, which increased by 17% over comparative volumes in 2018. When combined with renewals, total production increased from $25.9 billion in 2018 to $28.5 billion in 2019, or by 10%. One part of the strength in eastern Canada for new single-family origination is partially the result of the relaunch of its Excalibur program. Because of the successful launch of the product in 2018, the Company was able to quickly establish new origination volume. In 2019, growth for this program was similar to that of the overall single-family segment. The Company's expertise in mortgage underwriting drove commercial segment origination (including renewals) higher by 24% in 2019. Origination for direct securitization into NHA-MBS, CMB and ABCP programs remained a large part of the Company's strategy with volume of $8.9 billion in 2019.

Net Interest – Securitized Mortgages

Comparing the year ended December 31, 2019, to the year ended December 31, 2018, "net interest – securitized mortgages" decreased by about 4% to $138.6 million from $144.1 million. The decrease was largely due to the accounting for financial instruments. Prior to adopting hedge accounting in 2018, the Company recorded gains and losses on financial instruments in its current earnings and earned tighter or wider securitization spreads in future periods. In both 2017 and 2016, the Company recorded very large gains as interest rates began to climb. The offset to these gains is generally more expensive debt raised on the securitized mortgages. As the securitization transactions related to these debts performs, a lower net securitization margin is recorded. The Company estimates that the impact of this accounting treatment has decreased net interest on securitized mortgages in 2019 by about $8.3 million year over year. Without this amount, net interest on securitized mortgages increased by 2% between 2018 and 2019, as the Company increased the amount of mortgages pledged under securitization.

Placement Fees

Placement fee revenue increased by 45% to $205.5 million from $141.9 million in 2018. The increase was the result of a changing funding mix between the years. In 2019, the Company placed about $18.6 billion of volume with institutional investors compared to $14.9 billion in 2018. The increase of 25% drove most of the increase in placement fees. In 2018, a greater proportion of mortgage origination volume was securitized by the Company such that the value is now being recognized over time through net securitization margin. Placement fees on both newly originated and renewed single-family mortgages also benefited from the interest rate environment. As described previously, the Company does not apply any hedge accounting for the interest rate risk program related to its single-family mortgage commitment pipeline. Accordingly, any gains or losses related to the financial instruments used for this program are recorded in the Company's current period net income. To the extent that these mortgage commitments became funded mortgages, the mortgages may be more or less valuable given changes in the interest rate environment during the commitment period. In the first six months of 2019, bond yields dropped significantly, creating large losses on the financial instruments used to economically hedge these commitments. The Company expensed these losses. However, when the mortgage commitments related to these financial instruments transformed into funded mortgages, the mortgage rates on these mortgages were significantly higher than mortgage rates currently being offered at the time. The Company was able to immediately crystallize the value of such mortgages through placement transactions. Effectively, the Company recouped a portion of the losses on financial instruments recorded in the first two quarters of 2019 in third-quarter placement fees. The commercial segment was able to increase placement fees with increased pricing given demand from its customers. Single-family renewals, while lower than a year before, were comparatively more valuable to the Company than those in 2018.

Gains on Deferred Placement Fees

Gains on deferred placement fees revenue decreased 1% to $11.6 million from $11.7 million. The gains related to multi-unit residential mortgages originated and sold to institutional investors. Volumes for these transactions decreased by 6% from 2018, but spreads on these transactions widened year over year.

Mortgage Servicing Income

Mortgage servicing income increased 7% to $156.7 million from $146.2 million. This increase was largely due to the benefits associated with higher MUA and the funding shift from securitization to institutional placements, which effectively moves revenues from net securitization margin to servicing income.

Mortgage Investment Income

Mortgage investment income decreased 4% to $84.7 million from $88.3 million. The decrease was due primarily to lower mortgage rates, which prevailed in 2019 compared to 2018. Generally, five-year closed single-family mortgage rates fell by about 1% from the peak in 2018 to 2019's low.

Realized and Unrealized Gains (Losses) on Financial Instruments

This financial statement line item typically consists of three components: (1) gains and losses related to the Company's economic hedging activities of single-family commitments, (2) gains and losses related to holding a portfolio of mortgage and loan investments at fair value, and (3) gains and losses on interest rate swaps used to mitigate interest rate risk associated with its CMB activity. With the adoption of IFRS 9 in 2018, a significant portion of the Company's interest rate management program qualifies as hedging for accounting purposes. The Company has elected to document hedging relationships for virtually all of the multi-residential commitments and mortgages it originates for its own securitization programs. It has also done the same for the funded single-family mortgages and the swaps used in its ABCP programs. This decision has reduced the volatility of gains and losses on financial instruments otherwise recorded in the Company's regular earnings, as gains and losses on hedged items are generally deferred and amortized into income over the term of the related mortgages. The Company has not documented a hedging relationship for its interest mitigation program used to economically hedge commitments on single-family mortgages. The Company believes, given the optional nature of these commitments, it is difficult to establish a valid hedging relationship. For financial reporting purposes, this means that there will still be gains and losses on financial instruments, but these should be limited to those on the bonds sold short used to mitigate such risk. The Company has recorded mortgage and loan investments at fair value on its balance sheet. Accordingly, there are fair value gains or losses associated with these mortgages. The following table summarizes these gains and losses by category in the periods indicated:

SUMMARY OF REALIZED AND UNREALIZED GAINS (LOSSES) ON FINANCIAL INSTRUMENTS	**QUARTER ENDED**		**YEAR ENDED**	
($000s)	December 31, 2019	December 31, 2018	December 31, 2019	December 31, 2018
Gains (losses) on short bonds used for the economic hedging program	**5,931**	(14,285)	**(8,269)**	5,822
Losses on mortgages held at fair value	**(700)**	(1,000)	**(4,300)**	(4,000)
Gains (losses) on interest rate swaps	**244**	3,569	**2,914**	1,340
Net gains (losses) on financial instruments	**5,475**	(11,716)	**(9,655)**	3,162

In 2018, economic data was generally positive and interest rates began the year climbing slowly higher. However, in the fourth quarter of 2018, poor economic data moved rates lower. Together with the adoption of hedge accounting by the Company in 2018, which removes some of the volatility from its earnings, First National recorded gains on financial instruments of about $5.8 million related to its short bond hedging program in 2018. In 2019, economic concerns had a significant impact on the bond market, as bond prices rose in the first eight months of the year until receding toward year end. Overall, the Company experienced losses of $36.5 million on its total short bond book during the year ended December 31, 2019; however, about $28.2 million of these losses pertained to mortgages to which the Company was able to apply hedge accounting. This left losses on account of financial instruments in earnings of $8.3 million. These losses largely reflect the decrease in the value of short bonds used to mitigate interest rate risk related to the Company's single-family mortgage commitments. The Company does not attempt to document a hedge relationship on such commitments.

Brokerage Fees Expense

Brokerage fees expense increased 36% to $102.6 million from $75.4 million. This increase is explained by higher origination volumes of prime single-family mortgages for institutional investors, which increased by 32% year over year, excluding Excalibur product. Broker fees on a per unit basis were higher in 2019 compared to 2018 by about 6%, as the Company increased broker loyalty programs. Commercial segment broker fees were 15% higher in 2019 when compared to 2018.

Salaries and Benefits Expense

Salaries and benefits expense increased 18% to $117.6 million from $99.7 million. Salaries were higher as overall headcount increased by 7% (987 employees as at December 31, 2018, and 1,058 at December 31, 2019). The increase was also the result of $9.2 million of higher compensation earned by commercial sales staff pursuant to increased origination in 2019. Management salaries were paid to the two senior executives (co-founders) who together control about 71% 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") in 2006.

Interest Expense

Interest expense increased 11% to $77.7 million from $69.9 million. 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 investor or funding with a securitization vehicle. The Company used senior unsecured notes together with a $1.25 billion credit facility with a syndicate of banks and 30-day repurchase facilities to fund the mortgages during this period. The overall interest expense increased from the prior year due to higher short-term interest rates in 2019 and increased mortgage origination, which required higher levels of warehouse debt.

Other Operating Expenses

Other operating expenses decreased by 24% to $47.9 million from $63.0 million. The primary change in other operating expenses was lower hedge expenses, which were $15.9 million less than in 2018. The expense decreased as bond yields moved downward in 2019. With 30-day interest rates remaining relatively static, it became cheaper to borrow the short bonds that the Company uses to hedge interest rate exposure. As interest rates fell to start 2019, the yield curve became inverted such that short-term interest rates exceeded longer-term rates for much of the year. Accordingly, there was only $2.8 million of costs related to hedging in 2019. Without these costs, other operating expenses increased by $0.8 million, reflecting costs to support the growth of the business and MUA.

Income before Income Taxes and Pre-FMV EBITDA

Income before income taxes increased by 6% to $241.7 million from $227.4 million. This increase was the result of higher origination and a shift in funding strategy to a higher proportion of institutional placement. These results were affected by changing capital markets. In 2019, the Company recorded $5.4 million of losses on financial instruments (excluding $4.3 million of losses related to mortgage and loan investments). Comparatively, in 2018, the Company recorded $7.2 million of gains on financial instruments (excluding the impact of $4.0 million of losses related to mortgage and loan investments). The change in these values, excluding the losses on mortgage investments, accounted for a $12.5 million decrease in comparative income before income taxes. Pre-FMV EBITDA, which eliminates the impact of such gains and losses on financial instruments, increased by 12% to $251.3 million from $225.2 million. As described previously in this MD&A, not only did the Company increase new origination volumes by 13%, but it also increased the amount of mortgages placed with institutional investors. By placing mortgages with investors as opposed to using securitization, the Company effectively accelerates the recognition of the value inherent in the mortgages to the current accounting period. With wider mortgage spreads prevalent for much of 2019, the per unit values of the placements were more favourable than in 2018. Placement fee revenue was also affected favourably by a falling interest rate environment. As the Company committed to mortgages in the first six months of the year, funding costs decreased, and the value of the mortgages placed increased

“2019 results exceeded management’s expectations, as single-family origination increased by 11% from the comparative amount in 2018 and commercial segment origination increased by 19%.”

significantly. The Company had programs to mitigate the effect of changing interest rates on programs. The losses related to these instruments were recorded in the first two quarters of 2019. All together, the value of higher placement fee revenue, net of the cost of the related broker fees and additional commercial compensation, increased earnings by about $27 million year over year, accounting for most of the increase in Pre-FMV EBITDA.

Income Tax Expense

The provision for taxes increased by 6% to $64.5 million from $61.0 million. The provision increased proportionately with net income before income taxes. The overall effective tax rate was consistent between the two years.

Other Comprehensive Income

Beginning January 1, 2018, the Company adopted IFRS 9. As a part of this transition the Company began accounting for some of its interest rate risk mitigation strategies as hedges for reporting purposes. For the commercial segment, the Company hedges the interest rate risk associated with insured multi-residential mortgages. This hedging begins on commitment and ends when the Company either securitizes the mortgages (primarily through CMB funding) or places the mortgage with an institutional investor. As the Company determined that these hedges were effective, the Company recorded $25.1 million of pre-tax net losses on such hedges in 2019 that would have been recorded as losses on financial instruments under the previous IFRS standard. In the year, the Company amortized these losses and a portion of opening accumulated OCI into regular earnings. In 2019, $24.7 million of pre-tax OCI was amortized into the Company’s net income. The remaining OCI amount will be amortized into net income in future periods.

OPERATING SEGMENT REVIEW

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

FOR THE YEAR ENDED	RESIDENTIAL		COMMERCIAL	
($000s, except percent amounts)	December 31, 2019	December 31, 2018	December 31, 2019	December 31, 2018
Originations and renewals	**19,026,919**	18,314,129	**9,427,357**	7,574,443
Percentage change	***4%***		***24%***	
Revenue	**1,008,013**	913,301	**318,510**	268,209
Percentage change	***10%***		***19%***	
Income before income taxes	**171,423**	164,897	**70,290**	62,517
Percentage change	***4%***		***12%***	
AS AT	December 31, 2019	December 31, 2018	December 31, 2019	December 31, 2018
Identifiable assets	**28,535,288**	27,719,231	**9,120,529**	8,289,520
Mortgages under administration	**80,709,370**	79,165,363	**30,669,521**	26,985,711

RESIDENTIAL SEGMENT

Overall residential origination volumes including renewals increased by 4% between 2019 and 2018, while residential revenues increased by 10%. Revenues in both years were affected by gains and losses on fair value associated with changing interest rates. If revenues are normalized for these gains and losses, revenue would have increased by 12%. Revenue growth exceeded the growth in origination, as the Company placed a higher portion of its origination with institutional investors as opposed to using securitization. Placement transactions accelerate the recognition of the value inherent in a mortgage. Together with a wider spread environment, which increased the value of placement fees on a per unit basis, residential placement fee revenue increased by 46% year over year. Net income before tax was also affected by fair value related amounts. Without the impact of these revenues, net income before tax increased from $157.7 million in 2018 to $176.8 million in 2019, or by 12%. This was the result of higher placement fees as described above. The cost of originating mortgages on a per unit basis was similar year over year such that the additional placement revenue flowed through to increase net income. Identifiable assets increased from 2018 to 2019, as the Company increased its investment in mortgages pledged under securitization by about $450 million, restricted cash by about $100 million and hedging related assets by about $215 million.

COMMERCIAL SEGMENT

2019 commercial revenues increased by about 19% compared to 2018. This increase was the result of higher origination and interest revenue on the securitized mortgage portfolio that grew by 15% year over year. Income before income taxes for this segment was not affected by fair value considerations. This measure increased by 12% year over year. The increase is due to the higher revenue offset by higher compensation payable to the Company's commercial origination employees. Identifiable assets increased from those at December 31, 2018, as the Company increased its investment in mortgages pledged for securitization by $975 million and mortgage and loan investments by $150 million. This increase was offset by a decrease in mortgages accumulated for securitization of $315 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 should always be well bid and highly liquid. This strategy proved effective during the turmoil experienced in 2007 through 2009, when capital markets faltered and only the highest-quality assets were bid. As the Company's results in those years demonstrated, First National had little 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 unsecured notes 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 financial institutions for a total credit of $1.25 billion. This facility was extended in May 2019 for a five-year term maturing in May 2024. At December 31, 2019, the Company entered into repurchase transactions with financial institutions to borrow $1.1 billion related to $1.1 billion of mortgages held in "mortgages accumulated for sale or securitization" on the balance sheet.

At December 31, 2019, outstanding bank indebtedness was $797.8 million (December 31, 2018 – $918.3 million). Together with the unsecured notes of $375 million (December 31, 2018 – $175 million), this "combined debt" was used to fund $817.5 million (December 31, 2018 – $902.0 million) of mortgages accumulated for sale or securitization. At December 30, 2019, the Company's other interest-yielding assets included: (1) deferred placement fees receivable of $42.0 million (December 31, 2018 – $41.6 million) and (2) mortgage and loan investments of $370.4 million (December 31, 2018 – $188.7 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, 2018, and December 31, 2019, and now stands at $353.3 million (December 31, 2018 – $191.1 million). This represents a debt-to-equity ratio of approximately 0.63:1. This ratio increased from 0.36:1 at December 31, 2018. In general, the increase is due to the Company's investment in commercial bridge loans. Toward year end, a number of the Company's large customers required financing to transition their real estate portfolios between traditional mortgage financing solutions. In the month of December alone, the Company loaned about $150 million on such opportunities. The Company believes the ratio is appropriate given the nature of the assets which the debt is funding.

The Company funds a 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 by the Company. On specified days, 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 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.

The Company has used ABCP as an efficient source of funding primarily for short-term insured mortgages. In the May 2013 federal budget, the government announced it was going to take steps to limit the securitization of government-insured mortgages to CMHC-sponsored programs. As ABCP is not sponsored by CMHC, such a limitation does impact the Company. Almost two years after the announcement, legislation was passed, and detailed transition information was published. The legislation was reconfirmed in February 2016 with some delayed application dates. Generally, the regulations make mortgage default insurance invalid for any single-family mortgages with maturity dates beyond December 31, 2021, in a non-CMHC-sponsored securitization vehicle. Accordingly, existing single-family mortgages in ABCP conduits can be funded by ABCP until their maturity, not to exceed five years, and new insured single-family mortgages can be sold in as long as the maturity date of the mortgage is prior to January 1, 2022. As this date approaches, the Company must find other funding sources for the insured mortgages it has historically funded with ABCP. The Company is considering various alternatives, including whole loan sales and selling short-term NHA-MBS pools to ABCP conduits. The Company may also adjust its renewal offering to provide incentives to borrowers to select five-year terms as opposed to shorter terms. These alternatives may not be as economical to the Company as ABCP. 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. The most significant portion of cash collateral is the investment made on behalf of the Company's ABCP programs. As at December 31, 2019, the investment in cash collateral was $83.6 million (December 31, 2018 – $75.9 million).

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 March 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.

FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Commencing January 1, 2018, the Company has recorded mortgages accumulated for sale and 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 consolidated statement of income. The mortgages accumulated for sale are held for very short periods, and any change in value due to changing interest rates is the obligation of the ultimate institutional investor. Accordingly, the Company believes there will be little, if any, effect on its income related to the change in fair value of these mortgages. The majority of mortgages in mortgage and loan investments are uninsured commercial segment bridge loans. These are primarily floating rate loans that have mortgage terms of 18 months or less. As the mortgages do not conform to conventional mortgage lending, there are few active quoted markets available to determine the fair value of these assets. The Company estimates fair value based upon: benchmark interest rates, credit spreads for similar products, creditworthiness and status of the borrower, valuation of the underlying real property, payment history, and other conditions specific to the rationale for the loan. Any favourable or unfavourable amounts will be recorded in the statement of income 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. Prior to 2018, the Company did not attempt to adopt hedge accounting; however, with the introduction of IFRS 9 on January 1, 2018, the Company began designating hedging relationships such that the results of any effective hedging will not affect the Company's statement of income. See previous discussion in this MD&A under "Realized and Unrealized Gains (Losses) on Financial Instruments". As at December 31, 2019, the Company had about $1.5 billion 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 to be sold to the Company's other securitization vehicles. As at December 31, 2019, the Company had entered into $0.5 billion of notional value forward bond sales for this segment. The Company is also a party to four interest rate swaps that economically hedge the interest rate exposure related to certain CMB transactions in which the Company has replacement obligations. As at December 31, 2019, the aggregate notional value of these swaps, maturing between June 2021 and September 2026, was $68.4 million. During 2019, the value of these swaps increased by $2.9 million.

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 by adjusting the value of the mortgages downward. In 2009, the economic environment remained weak but did not worsen from 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 June 2011 and continuing through 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, 2019, the Company had various exposures to changing credit spreads. In particular, in mortgages accumulated for sale or securitization, there were almost $1.9 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. The business requires capital expenditures on technology (both software and hardware), leasehold improvements, and office furniture. During the year ended December 31, 2019, the Company purchased new computer equipment, software and made leasehold improvements. In the long term, the Company expects capital expenditures on fixed assets will be approximately $6.0 million annually.

SUMMARY OF CONTRACTUAL OBLIGATIONS

The Company's long-term obligations include five- to 10-year leases of premises for its 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.

PAYMENTS DUE BY PERIOD

($000s)	**Total**	0–1 years	1–3 years	4–5 years	After 5 years
Lease obligations	29,086	7,484	21,602	—	—

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 annual consolidated financial statements as at December 31, 2019. The policies that 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 assumes there is virtually no prepayment on multi-unit residential fixed-rate mortgages. Currently there are no deferred placement fees related to single-family 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 method of determining the assumptions underlying the estimates used for the quarter ended December 31, 2019, continue to be consistent with those used for the year ended December 31, 2018, and the quarters ended September 30, June 30, and March 31, 2019.

Effective January 1, 2018, the Company elected to treat certain of its financial assets and liabilities, including mortgages accumulated for sale, 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. If the bonds sold short are designated as an effective hedge, a portion of the change in the short bonds' fair value may be recorded in Other Comprehensive Income or deferred against hedge assets. This accounting should reduce the volatility in current earnings as changes in the value on short bonds should be better matched to the change in value of the hedged items (mortgages). 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 the assets listed above are subject to Company estimates. The most significant would be implicit in the valuation of mortgage and loan investments. These are generally non-homogeneous mortgages and other loans where it is difficult to find independent valuation comparatives. The Company uses information in its underwriting files, regional real estate information and other internal measures to determine the fair value of these assets.

As a mortgage lender, the Company invests in uninsured mortgages. When it funds these mortgages through securitization debt, it continues to be liable for any credit losses. The key inputs in the measurement of any expected credit loss ("ECL") include probability of default, loss given default and forecast of future economic conditions, which involves significant judgment. Upon application of IFRS 9 with respect to impairment, there has been no impact on the Company's earnings. Because of the high proportion of government-insured mortgages in its securitized portfolio and the low historical loss rates on the uninsured mortgages on which the Company lends, ECL has been determined to be insignificant.

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, 2019, 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, 2019.

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, 2019, and that no material weaknesses have been identified in the Company's internal control over financial reporting as of December 31, 2019. No changes were made in the Company's internal controls over financial reporting during the year ended December 31, 2019, 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 including third-party servicing customers, reliance on independent mortgage brokers, changes in interest rates, repurchase obligations and breach of representations and warranties on mortgage sales, risk of servicer termination including the impact of trigger events on cash collateral and retained interests, reliance on multi-unit residential and commercial mortgages, general economic conditions, legislation and government regulation (including regulations imposed by the Department of Finance, CMHC and the policies set by and for mortgage default insurance companies), potential for losses on uninsured mortgages, 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, unfavourable litigation, and environmental liability. In addition, there are risks associated with the structure of the Company, including: those related to the dependence on FNFLP, leverage and restrictive covenants, dividends that are not guaranteed and could fluctuate with the Company's performance, restrictions on potential growth, the market price of the Company's shares, statutory remedies, control of the Company, and contractual restrictions. The Company is subject to Canadian federal and provincial income and commodity tax laws and pays such taxes as it determines are compliant with such legislation. Among the risks of all potential tax matters, there is a risk that tax legislation changes are detrimental to the Company or that Canadian tax authorities interpret tax legislation differently than the Company's filing positions. 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. In October 2019, the sale transaction involving an institution for which the Company administers a large portfolio of third-party originated mortgages was completed. The new owners of the institution may decide not to renew the existing contract with First National or to exercise termination clauses within the agreement. In the event of non-renewal or termination, the Company's MUA will decrease. 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 in the “Risk and Uncertainties Affecting the Business” section. In evaluating this information, the reader should specifically consider various factors, including the risks outlined in the “Risk and Uncertainties Affecting the Business” section, 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, 2020, 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

2019 results exceeded management’s expectations, as single-family origination increased by 11% from the comparative amount in 2018 and commercial segment origination increased by 19%. Management remains optimistic about 2020, as single-family mortgage commitments have continued to outpace commitments at the same time in 2019. The commercial segment also anticipates a strong start to 2020, as borrower appetite continues to be strong following the record fourth quarter of 2019. Despite these favourable indications, the Company will continue to be faced with uncertain securitization margins, as mortgage spreads have tightened toward the end of 2019 and have not widened in early 2020. The effect of pre-2018 fair value accounting conventions will continue to have a negative impact on income in 2020, albeit for a slightly lower amount than in 2019.

The Company is confident that its strong relationships with mortgage brokers and diverse funding sources will continue to set First National apart from its competition. The Company will continue to generate income and cash flow from its $32 billion portfolio of mortgages pledged under securitization and $77 billion servicing portfolio and focus on the value inherent in its significant single-family renewal book.

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The management of First National Financial Corporation (the "Company") is responsible for the integrity, consistency and reliability of the consolidated financial statements and Management's Discussion and Analysis ("MD&A"). The consolidated financial statements have been prepared by Management in accordance with International Financial Reporting Standards.

We certify that we have reviewed the financial statements and information contained in the MD&A, and, based on our knowledge, they do not contain any untrue statement of a material fact or omit to state a material fact required to be stated or that is necessary to make a statement not misleading in light of the circumstances under which it was made, with respect to the period covered by the statements and the annual report. Based on our knowledge, the financial statements together with MD&A and other financial information included in the annual report fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of the dates and for the periods presented. The preparation of financial statements involves transactions affecting the current period which cannot be finalized with certainty until future periods. Estimates and assumptions are based on historical experience and current conditions, and are believed to be reasonable.

We are responsible for establishing and maintaining internal control over financial reporting for the Company. We have designed such internal control over financial reporting, or caused it to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes. We evaluated, or caused to be evaluated under our supervision, the effectiveness of the Company's internal control over financial reporting at the financial year end and the Company has disclosed in its annual MD&A our conclusion about the effectiveness of internal control over financial reporting at the financial year-end based on that evaluation. We have also disclosed in the MD&A any change in our internal control over financial reporting that occurred during the year that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

The Board of Directors oversees that management fulfils its responsibility for financial reporting and internal control. The financial statements have been reviewed by the Audit Committee and approved by the Board of Directors. Ernst & Young LLP, the independent auditors appointed by the shareholders, has performed an independent audit of the Company's consolidated financial statements and provide their report which follows. 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 Smith

STEPHEN SMITH
Chairman and Chief Executive Officer

ROBERT INGLIS
Chief Financial Officer
February 24, 2020

INDEPENDENT AUDITOR'S REPORT

Report on the audit of the consolidated financial statements

TO THE SHAREHOLDERS OF FIRST NATIONAL FINANCIAL CORPORATION

Opinion

We have audited the consolidated financial statements of First National Financial Corporation and its subsidiaries (collectively, the "Company"), which comprise the consolidated statements of financial position as at December 31, 2019 and December 31, 2018, and the consolidated statements of income, comprehensive income, changes in equity and cash flows for the years then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as at December 31, 2019 and December 31, 2018, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards ("IFRSs").

Basis for opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the consolidated financial statements section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada, and we have fulfilled our ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other information

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

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

Our opinion on the consolidated financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

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

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

Responsibilities of management and those charged with governance for the consolidated financial statements

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

In preparing the consolidated financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

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

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure, and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

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

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

Ernst & Young LLP

Chartered Professional Accountants
Licensed Public Accountants

Toronto, Canada
February 24, 2020

"Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement."

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

As at December 31

(in thousands of Canadian dollars)	Notes	2019	2018
ASSETS			
Restricted cash	3	**681,596**	577,096
Cash held as collateral for securitization	3	**83,587**	75,913
Accounts receivable and sundry		**131,042**	150,668
Mortgages accumulated for sale or securitization	5	**1,918,581**	2,204,886
Mortgages pledged under securitization	3	**31,995,424**	30,567,036
Deferred placement fees receivable	4	**42,046**	41,584
Mortgage and loan investments	6	**370,414**	188,666
Income taxes recoverable	18	**—**	3,982
Securities purchased under resale agreements	15	**2,414,835**	2,188,149
Other assets	7	**48,068**	39,147
Total assets		**$37,685,593**	$36,037,127
LIABILITIES AND EQUITY			
Liabilities			
Bank indebtedness	9	**797,758**	918,347
Obligations related to securities and mortgages sold under repurchase agreements	15	**1,072,062**	1,262,395
Accounts payable and accrued liabilities	16	**149,906**	106,095
Securities sold short	14	**2,397,325**	2,183,411
Debt related to securitized mortgages	10	**32,245,793**	30,781,007
Senior unsecured notes	12	**374,025**	174,829
Income taxes payable	18	**4,764**	—
Deferred tax liabilities	18	**82,300**	78,800
Total liabilities		**$37,123,933**	$35,504,884
Common shares	17	**122,671**	122,671
Preferred shares	17	**97,394**	97,394
Retained earnings		**345,029**	315,294
Accumulated other comprehensive income		**(3,434)**	(3,116)
Total equity		**561,660**	532,243
Total liabilities and equity		**$37,685,593**	$36,037,127

See accompanying notes

On behalf of the Board:

JOHN BROUGH
Director

ROBERT MITCHELL
Director

CONSOLIDATED STATEMENTS OF INCOME

Years ended December 31

(in thousands of Canadian dollars, except earnings per share)	Notes	2019	2018
REVENUE			
Interest revenue – securitized mortgages		**877,720**	790,192
Interest expense – securitized mortgages		**(739,071)**	(646,069)
Net interest – securitized mortgages	3	**138,649**	144,123
Placement fees		**205,451**	141,887
Gains on deferred placement fees	4	**11,619**	11,747
Mortgage investment income		**84,670**	88,325
Mortgage servicing income		**156,718**	146,197
Realized and unrealized gains (losses) on financial instruments	19	**(9,655)**	3,162
		$ 587,452	$535,441
EXPENSES			
Brokerage fees		**102,596**	75,354
Salaries and benefits		**117,575**	99,735
Interest		**77,700**	69,949
Other operating		**47,868**	62,986
		$345,739	$308,024
INCOME BEFORE INCOME TAXES		**241,713**	227,417
Income tax expense	18	**64,500**	60,990
Net income for the year		**$177,213**	$166,427
EARNINGS PER SHARE			
Basic	17	**2.90**	2.73

See accompanying notes

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Years ended December 31

(in thousands of Canadian dollars)	2019	2018
NET INCOME FOR THE YEAR	**177,213**	166,427
OTHER COMPREHENSIVE INCOME (LOSS) ITEMS THAT MAY BE SUBSEQUENTLY RECLASSIFIED TO INCOME		
Net gains (losses) from change in fair value of cash flow hedges	**(25,118)**	3,210
Reclassification of net (gains) losses to income	**24,700**	(7,466)
	(418)	(4,256)
Income tax recovery	**100**	1,140
Total other comprehensive income	**(318)**	(3,116)
Total comprehensive income	**$176,895**	$163,311

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

Years ended December 31

(in thousands of Canadian dollars)	Common shares	Preferred shares	Retained earnings	Accumulated other comprehensive loss	Total equity
BALANCE AS AT JANUARY 1, 2019	**122,671**	**97,394**	**315,294**	**(3,116)**	**532,243**
Net income for the year	**—**	**—**	**177,213**	**—**	**177,213**
Other comprehensive loss	**—**	**—**	**—**	**(318)**	**(318)**
Dividends paid or declared	**—**	**—**	**(147,478)**	**—**	**(147,478)**
BALANCE AS AT DECEMBER 31, 2019	**$122,671**	**$97,394**	**$345,029**	**$(3,434)**	**$561,660**

	Common shares	Preferred shares	Retained earnings	Accumulated other comprehensive loss	Total equity
BALANCE AS AT JANUARY 1, 2018	122,671	97,394	323,202	—	543,267
Net income for the year	—	—	166,427	—	166,427
Other comprehensive loss	—	—	—	(3,116)	(3,116)
Dividends paid or declared	—	—	(174,335)	—	(174,335)
BALANCE AS AT DECEMBER 31, 2018	$122,671	$97,394	$315,294	$(3,116)	$532,243

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31

(in thousands of Canadian dollars)	2019	2018
OPERATING ACTIVITIES		
Net income for the year	**177,213**	166,427
Add (deduct) items		
Deferred income taxes	**3,600**	5,190
Non-cash portion of gains on deferred placement fees	**(11,176)**	(11,298)
Increase in restricted cash	**(104,500)**	(15,626)
Net investment in mortgages pledged under securitization	**(1,403,327)**	(2,982,003)
Net increase in debt related to securitized mortgages	**1,439,725**	2,910,538
Securities purchased under resale agreements, net	**(226,686)**	(2,787)
Securities sold short, net	**258,081**	(27,851)
Amortization of deferred placement fees receivable	**10,714**	10,987
Amortization of property, plant and equipment	**7,813**	4,931
Unrealized losses (gains) on financial instruments	**(43,200)**	29,413
	108,257	87,921
Net change in non-cash working capital balances related to operations	**350,440**	(425,261)
Cash provided by (used in) operating activities	**$458,697**	$(337,340)
INVESTING ACTIVITIES		
Additions to property, plant and equipment	**(5,874)**	(2,632)
Investment of cash held as collateral for securitization	**(7,673)**	(9,500)
Investment in mortgage and loan investments	**(1,142,162)**	(866,787)
Repayment of mortgage and loan investments	**956,114**	1,053,834
Cash provided by (used in) investing activities	**$(199,595)**	$174,915
FINANCING ACTIVITIES		
Dividends paid	**(147,220)**	(174,031)
Obligations related to securities and mortgages sold under repurchase agreements	**(190,333)**	62,260
Decrease in debt related to participation mortgages	**—**	(323)
Issuance of senior unsecured notes	**199,040**	—
Cash used in financing activities	**$(138,513)**	$(112,094)
Net decrease (increase) in bank indebtedness during the year	**120,589**	(274,519)
Bank indebtedness, beginning of year	**(918,347)**	(643,828)
Bank indebtedness, end of year	**$(797,758)**	$(918,347)
SUPPLEMENTAL CASH FLOW INFORMATION		
Interest received	**1,031,267**	941,551
Interest paid	**779,504**	668,301
Income taxes paid	**52,154**	66,973

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars, unless otherwise indicated)

December 31, 2019 and 2018

1. GENERAL ORGANIZATION AND BUSINESS OF FIRST NATIONAL FINANCIAL CORPORATION

First National Financial Corporation (the "Corporation" or "Company") is the parent company of First National Financial LP ("FNFLP"), a Canadian-based originator, underwriter and servicer of predominantly prime residential (single family and multi-unit) and commercial mortgages. With over $111 billion in mortgages under administration as at December 31, 2019, FNFLP is a significant participant in the mortgage broker distribution channel.

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

2. SIGNIFICANT ACCOUNTING POLICIES

(A) BASIS OF PREPARATION

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). The consolidated financial statements have been prepared on a historical cost basis, except for derivative financial instruments and certain financial assets and financial liabilities that are recorded at fair value through profit or loss ("FVTPL") and measured at fair value. The carrying values of recognized assets and liabilities that are designated as hedged items in fair value hedges, and that would otherwise be carried at amortized cost, are adjusted to record changes in fair value attributable to the risks that are being mitigated in effective hedge relationships. The consolidated financial statements are presented in Canadian dollars and all values are rounded to the nearest thousand except when otherwise indicated. The consolidated financial statements were authorized for issue by the Board of Directors on February 24, 2020.

(B) BASIS OF CONSOLIDATION

The consolidated financial statements comprise the financial statements of the Company and its subsidiaries, including FNFLP, First National Financial GP Corporation ("GP", the general partner of FNFLP), FNFC Trust, a special purpose entity ("SPE") that is used to manage undivided co-ownership interests in mortgage assets funded with asset-backed commercial paper ("ABCP"), First National Asset Management Inc. ("FNAM"), and First National Mortgage Corporation.

FNAM is a wholly owned subsidiary of the GP, and an indirect subsidiary of the Company. FNAM is an NHA approved lender and NHA-MBS issuer in the capacity of an "aggregator". Its business model is to purchase mortgages from mortgage originators in order to create NHA-MBS pools, and subsequently sell these into the Canada Mortgage Bonds ("CMB") programs.

The Company did not consolidate, in its financial statements, three SPEs over which the Company does not have control. The SPEs are sponsored by third-party financial institutions that acquire assets from various sellers, including mortgages from the Company. The Company earns interest income from the retained interest related to these mortgages. As at December 31, 2019, the Company recorded, on its consolidated statements of financial position, its portion of the assets of the SPEs amounting to $1,275 million (2018 – $801 million). The Company also recorded, in its consolidated statements of income, interest revenue – securitized mortgages of $31.4 million (2018 – $27.9 million) and interest expense – securitized mortgages of $27.4 million (2018 – $22.3 million) related to its interest in the SPEs.

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

(C) USE OF ESTIMATES

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

(D) SIGNIFICANT ACCOUNTING POLICIES

Changes in Accounting Policies

IFRS 16 – Leases

On January 1, 2019, the Company adopted IFRS 16 – Leases ("IFRS 16"). The Company has elected to apply IFRS 16 on a modified retrospective approach, with no restatement of comparative period results.

The Company has applied the cost method to measure the right-of-use asset. The right-of-use asset is subsequently amortized using the straight-line method. If any impairment is identified, the unamortized balance related to the impaired asset is charged fully to income. The lease liability is calculated using the present value of future lease payment, discounted at the Company's incremental borrowing rate. The lease liability is subsequently measured at amortized cost.

The Company's major leases are for premises at its Toronto head office and four regional offices. The Company has elected not to recognize right-of-use assets and a lease liability for its various office equipment leases, which are insignificant for application of the new standard. As a result of adopting the new standard, the Company recorded a right-of-use asset of $10,859 and a lease liability of $10,859 on January 1, 2019.

Financial Instruments

The Company accounts for its financial assets and liabilities in accordance with IFRS – Financial Instruments ("IFRS 9").

Classification and Measurement of Financial Assets

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

Securities purchased under resale agreements	Amortized cost
Mortgages accumulated for securitization	Amortized cost
Mortgages accumulated for sale	FVTPL
Mortgages pledged under securitization	Amortized cost
Mortgage and loan investments	FVTPL
Deferred placement fees receivable	Amortized cost

Classification and Measurement of Financial Liabilities

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

Obligations related to securities and mortgages sold under repurchase agreements	FVTPL
Securities sold short	FVTPL
Debt related to securitized mortgages	Amortized cost
Servicing liabilities	Amortized cost
Senior unsecured notes	Amortized cost

Impairment

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

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

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

Hedge Accounting

On January 1, 2018, the Company commenced IFRS 9 hedge accounting for certain mortgage commitments and funded mortgages.

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

Cash Flow Hedges

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

Fair Value Hedges

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

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

Revenue Recognition

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

Interest Revenue and Expense from Mortgages Pledged under Securitization

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

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

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

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

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

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

Derecognition

A financial asset is derecognized when:

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

Placement Fees and Deferred Placement Fees Receivable

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

Mortgage Servicing Income

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

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

Mortgage Investment Income

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

Brokerage Fees

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

Mortgages Pledged under Securitization

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

Debt Related to Securitized Mortgages

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

Mortgages Accumulated for Sale or Securitization

Mortgages accumulated for sale are mortgages funded pending subsequent settlement with institutional investors and are classified as FVTPL and recorded at fair value. These mortgages are held for terms usually not exceeding 90 days.

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

Securities Sold Short and Securities Purchased under Resale Agreements

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

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

Mortgage and Loan Investments

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

Property, Plant and Equipment

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

Computer equipment	30% declining balance
Office equipment	20% declining balance
Leasehold improvements	Straight-line over the term of the lease
Computer software	30% declining balance except for certain computer licenses, which are straight-line over useful lives

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

Goodwill

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

Restricted Cash

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

Bank Indebtedness

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

Cash Held as Collateral for Securitization

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

Servicing Liability

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

Income Taxes

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

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

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

Earnings per Common Share

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

3. MORTGAGES PLEDGED UNDER SECURITIZATION

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

As part of the ABCP transactions, the Company provides cash collateral for credit enhancement purposes, as required by the rating agencies. Credit exposure to securitized mortgages is generally limited to this cash collateral. The principal and interest payments on the securitized mortgages are paid by the Company to the structured entities monthly over the term of the mortgages. The full amount of the cash collateral is recorded as an asset and the Company anticipates full recovery of these amounts. NHA MBS securitizations may also require cash collateral in some circumstances. As at December 31, 2019, the cash held as collateral for securitization was $83,587 (2018 – $75,913).

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

	2019	
	Carrying amount of securitized mortgages ($)	Carrying amount of associated liabilities ($)
Securitized mortgages	31,776,442	32,303,342
Capitalized amounts related to hedge accounting	43,280	43,418
Capitalized origination costs	175,702	—
Debt discounts	—	(100,967)
	$31,995,424	$32,245,793
Add		
Principal portion of payments recorded in restricted cash	623,253	—
	$32,618,677	$32,245,793

	2018	
	Carrying amount of securitized mortgages ($)	Carrying amount of associated liabilities ($)
Securitized mortgages	30,385,005	30,876,519
Capitalized amounts related to hedge accounting	12,578	18,356
Capitalized origination costs	169,453	—
Debt discounts	—	(113,868)
	$30,567,036	$30,781,007
Add		
Principal portion of payments held in restricted cash	521,690	—
	$31,088,726	$30,781,007

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

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

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

	2019	2018
OPENING BALANCE, JANUARY 1	**169,453**	141,121
Add: new origination costs capitalized in the year	**85,421**	103,222
Less: amortization in the year	**(79,172)**	(74,890)
ENDING BALANCE, DECEMBER 31	**$175,702**	$169,453

During the year ended December 31, 2019, the Company invested in mortgages that were transferred into the securitization vehicles with principal balances as of December 31, 2019, of $7,076,837 (2018 – $7,418,415).

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

2020	3,977,269
2021	4,965,861
2022	6,584,375
2023	7,041,222
2024 and thereafter	9,207,715
	$31,776,442

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

	2019	2018
ARREARS DAYS		
31 to 60	**32,244**	48,902
61 to 90	**5,279**	4,814
Greater than 90	**25,683**	16,380
	$63,206	$70,096

All the mortgages pledged under securitization in arrears are insured, except for five mortgages that are uninsured and have a total principal balance of $874 as at December 31, 2019 (2018 – two mortgages, $605). The Company's exposure to credit loss is limited to uninsured mortgages with principal balances totalling $1,975,154 (2018 – $1,251,236), before consideration of the value of underlying collateral. The majority of such mortgages are conventional prime single-family mortgages, with an 80% or less loan to value ratio at origination, and verified borrower income. Accordingly, the expected credit loss related to these mortgages is insignificant. The Company has provided $214 for ECL for the year ended December 31, 2019 (2018 – nil).

4. DEFERRED PLACEMENT FEES RECEIVABLE

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

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

During the year ended December 31, 2019, $2,419,508 (2018 – $2,655,764) of mortgages were placed with institutional investors, which created gains on deferred placement fees of $11,619 (2018 – $11,747). Cash receipts on deferred placement fees receivable for the year ended December 31, 2019, were $12,655 (2018 – $12,979).

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

2020	11,688
2021	9,709
2022	7,701
2023	6,039
2024 and thereafter	12,834
	$47,971

5. MORTGAGES ACCUMULATED FOR SALE OR SECURITIZATION

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

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

	2019	**2018**
Mortgages accumulated for securitization	**1,884,571**	2,170,416
Mortgages accumulated for sale	**34,010**	34,470
	$1,918,581	$2,204,886

The Company's exposure to credit loss is limited to $587,465 (2018 – $321,341) of principal balances of uninsured mortgages within mortgages accumulated for securitization, before consideration of the value of underlying collateral. As at December 31, 2019, none of these mortgages is in arrears past 31 days. These are primarily conventional prime single-family mortgages similar to the mortgages described in note 3. Accordingly, the expected credit loss related to these mortgages is insignificant.

6. MORTGAGE AND LOAN INVESTMENTS

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

Mortgage and loan investments are measured at FVTPL, and are recorded on a fair value basis. Any changes in fair value are immediately recognized in income. The Company recorded a fair value loss of $4,300 (2018 – $4,000) for the year ended December 31, 2019.

The following table discloses the composition of the Company's portfolio of mortgage and loan investments by geographic region as at December 31, 2019:

Province/Territory	Portfolio balance	Percentage of portfolio
Alberta	**8,163**	2.20
British Columbia	**20,734**	5.60
Manitoba	**11,904**	3.21
New Brunswick	**844**	0.23
Newfoundland and Labrador	**717**	0.19
Nova Scotia	**33,094**	8.93
Nunavut	**105**	0.03
Ontario	**252,859**	68.26
Quebec	**41,198**	11.12
Saskatchewan	**502**	0.14
Yukon	**249**	0.07
Prince Edward Island	**44**	0.01
	$370,414	100.00%

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

	2019	2018
ARREARS DAYS		
31 to 60	**5,016**	4,871
61 to 90	**4**	
Greater than 90	**34,235**	39,232
	$39,255	$44,103

The portfolio contains $18,209 (December 31, 2018 – $13,133) of insured mortgages and $352,205 (December 31, 2018 – $175,533) of uninsured mortgage and loan investments as at December 31, 2019. Of the uninsured mortgages, approximately $35,014 (December 31, 2018 – $39,941) have principal balances in arrears of more than 30 days. Three of these mortgages are non-performing and the Company has stopped accruing interest. These mortgages had a total original principal balance of $38,825 and are recorded at a fair value of $13,133 as at December 31, 2019 (December 31, 2018 – three mortgages, original principal balance of $44,001, and fair value of $22,609).

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

						2019	2018
	2020	2021	2022	2023	2024 and thereafter	Book value	Book value
Residential	**36,095**	**8,822**	**5,039**	**3,168**	**18,467**	**71,591**	36,527
Commercial	**263,126**	**27,796**	**6,887**	**279**	**735**	**298,823**	152,139
	$299,221	**$36,618**	**$11,926**	**$3,447**	**$19,202**	**$370,414**	$188,666

Interest income earned for the year was $15,065 (2018 – $17,654) and is included in mortgage investment income on the consolidated statements of income.

7. OTHER ASSETS

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

	2019	2018
Property, plant and equipment, net	**11,029**	9,371
Right-of-use assets	**7,263**	—
Goodwill	**29,776**	29,776
	$48,068	$39,147

The right-of-use assets pertain to five premises leases for the Company's office space across the country. The leases have remaining terms of three to five years. The related lease liability of $7,466 as at December 31, 2019, is grouped with accounts payable and accrued liabilities on the consolidated statements of financial position.

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

8. MORTGAGES UNDER ADMINISTRATION

As at December 31, 2019, the Company managed mortgages under administration of $111,378,891 (2018 – $106,151,363), including mortgages held on the Company's consolidated statements of financial position. Mortgages under administration are serviced for financial institutions such as banks, insurance companies, pension funds, mutual funds, trust companies, credit unions and securitization vehicles. As at December 31, 2019, the Company administered 310,415 mortgages (2018 – 306,221) for 108 institutional investors (2018 – 111) with an average remaining term to maturity of 40 months (2018 – 40 months).

Mortgages under administration are serviced as follows:

	2019	2018
Institutional investors	**76,040,779**	72,209,810
Mortgages accumulated for sale or securitization and mortgage and loan investments	**2,306,608**	2,387,285
Mortgages pledged under securitization	**31,776,442**	30,385,005
CMBS conduits	**1,255,062**	1,169,263
	$111,378,891	$106,151,363

The Company's exposure to credit loss is limited to mortgage and loan investments as described in note 6, securitized mortgages as described in note 3 and uninsured mortgages held in mortgages accumulated for securitization as described in note 5. As at December 31, 2019, the Company has included in accounts receivable and sundry $156 (2018 – $86) of uninsured non-performing mortgages.

The Company maintains trust accounts on behalf of the investors it represents. The Company also holds municipal tax funds in escrow for mortgagors. Since the Company does not hold a beneficial interest in these funds, they are not presented on the consolidated statements of financial position. The aggregate of these accounts as at December 31, 2019, was $690,394 (2018 – $630,166).

9. BANK INDEBTEDNESS

Bank indebtedness includes a revolving credit facility of $1,250,000 (2018 – $1,250,000) maturing in March 2024. At December 31, 2019, $797,758 (2018 – $918,347) was drawn, of which the following have been pledged as collateral:

(a) A general security agreement over all assets, other than real property, of the Company; and

(b) A general assignment of all mortgages owned by the Company.

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

10. DEBT RELATED TO SECURITIZED MORTGAGES

Debt related to securitized mortgages represents the funding for mortgages pledged under the NHA-MBS, CMB and ABCP programs. As at December 31, 2019, debt related to securitized mortgages was $32,245,793 (2018 – $30,781,007), net of unamortized discounts of $100,967 (2018 – $113,868). A comparison of the carrying amounts of the pledged mortgages and the related debt is summarized in note 3.

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

11. SWAP CONTRACTS

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

The following tables present, by remaining term to maturity, the notional amounts and fair values of the swap contracts outstanding as at December 31, 2019 and 2018:

			2019		
	Less than 3 years	3 to 5 years	6 to 10 years	Total notional amount	Fair value
Interest rate swap contracts	**$2,560,603**	**$1,122,379**	**$32,442**	**$3,715,424**	**$18,402**

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

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

12. SENIOR UNSECURED NOTES

On April 9, 2015, the Company issued $175 million Series 1 senior unsecured notes for a five-year term maturing on April 9, 2020. The notes bear interest at 4.01% payable in equal semi-annual payments commencing October 9, 2015. The net proceeds of the issuance ($174.3 million, net of financing fees) have been invested in FNFLP.

On November 25, 2019, the Company issued $200 million Series 2 senior unsecured notes for a five-year term pursuant to a private placement under an offering memorandum. The notes bear interest at 3.582% payable in equal semi-annual payments commencing May 25, 2020. On settlement, the net proceeds of the offering ($199.3 million, net of financing fees) were loaned to FNFLP.

13. COMMITMENTS, GUARANTEES AND CONTINGENCIES

As at December 31, 2019, the Company has the following operating lease commitments for its office premises:

2020	7,484
2021	7,255
2022	8,004
2023 and thereafter	6,343
	$29,086

Outstanding commitments for future advances on mortgages with terms of one to 10 years amounted to $1,446,303 as at December 31, 2019 (2018 – $1,192,677). 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. A portion of the Company's commitments for premises listed above have been accounted in right-of-use assets and recorded as other assets on the consolidated statements of financial position.

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

14. SECURITIES TRANSACTIONS UNDER REPURCHASE AND RESALE AGREEMENTS

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

15. OBLIGATIONS RELATED TO SECURITIES AND MORTGAGES SOLD UNDER REPURCHASE AGREEMENTS

The Company uses repurchase agreements to fund specific mortgages included in mortgages accumulated for sale or securitization. The current contracts are with financial institutions, are based on bankers' acceptance rates and mature on or before January 31, 2020.

16. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

	2019	2018
Accrued liabilities	**52,748**	20,088
Accrued dividends payable	**10,508**	10,249
Accrued interest on securitization debt	**58,225**	57,777
Servicing liability	**20,959**	17,981
Lease liability	**7,466**	—
	$149,906	$106,095

17. SHAREHOLDERS' EQUITY

(a) Authorized

Unlimited number of common shares

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

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

(b) Capital Stock

Balance, December 31, 2019 and 2018

	#	$
Common shares	**59,967,429**	**$122,671**
Preferred shares	**4,000,000**	**$97,394**

(c) Preferred Shares

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

Holders of Class A Series 1 Preferred Shares have the right, at their option, to convert their shares into cumulative, floating rate Class A Preferred Shares, Series 2 ("Series 2 Preferred Shares"), subject to certain conditions, on March 31, 2021, and on March 31 every five years thereafter. As of December 31, 2019, and December 31, 2018, there were 2,887,147 Series 1 Preferred Shares and 1,112,853 Series 2 Preferred Shares outstanding, with a total carrying value of $97,394.

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

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

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

(d) Earnings per Share

	2019	2018
Net income attributable to shareholders	**177,213**	166,427
Less: dividends declared on preferred shares	**(3,057)**	(2,928)
Net earnings attributable to common shareholders	**174,156**	163,499
Number of common shares outstanding	**59,967,429**	59,967,429
Basic earnings per common share	**$2.90**	$2.73

18. INCOME TAXES

The major components of deferred provision for income taxes for the years ended December 31 consist of the following:

	2019	2018
Related to origination and reversal of timing differences	**3,769**	4,857
Increase (decrease) in future tax rates	**(169)**	333
	$3,600	$5,190

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

	2019	2018
Income taxes relating to the current year	**60,900**	56,100
Income taxes related to the prior year	**—**	(300)
	$60,900	$55,800

The effective income tax rate reported in the consolidated statements of income varies from the Canadian tax rate of 26.61% for the year ended December 31, 2019 (2018 – 26.64%) for the following reasons:

	2019	2018
COMPANY'S STATUTORY TAX RATE	**26.61%**	26.64%
Income before income taxes	**241,713**	227,417
Income tax at statutory tax rate	**64,320**	60,584
Increase (decrease) resulting from		
Permanent differences	**345**	316
Changes in future tax rates	**(169)**	333
Tax recovery from prior years	**—**	(300)
Other	**4**	57
INCOME TAX EXPENSE	**$64,500**	$60,990

The movement in significant components of the Company's deferred income tax liabilities and assets for the years ended December 31, 2019 and 2018 are as follows:

	As at January 1, 2019	Recognized in income and OCI	As at December 31, 2019
DEFERRED INCOME TAX			
Deferred placement fees receivable	**11,078**	**111**	**11,189**
Deferred costs – securitization	**75,370**	**(2,621)**	**72,749**
Unrealized gains on interest rate swaps	**5,885**	**7,469**	**13,354**
Other	**64**	**441**	**505**
Right-of-use asset	**2,890**	**(957)**	**1,933**
Lease liability	**(2,890)**	**903**	**(1,987)**
Carrying values of mortgages pledged under securitization in excess of tax values	**(424)**	**(157)**	**(581)**
Cumulative eligible capital property	**(4,261)**	**303**	**(3,958)**
Servicing liability	**(4,790)**	**(787)**	**(5,577)**
Fair value adjustments not deducted for tax purposes	**(4,122)**	**(1,205)**	**(5,327)**
Total	**$78,800**	**$3,500**	**$82,300**

The amount of deferred tax expense recorded in income and OCI consists of $3,600 recorded in net income and a recovery of $100 recorded in OCI related to unrealized losses on cash flow hedges.

	As at January 1, 2018	Recognized in income and OCI	As at December 31, 2018
DEFERRED INCOME TAX			
Deferred placement fees receivable	10,946	132	11,078
Deferred costs – securitization	58,916	16,457	75,370
Unrealized gains on interest rate swaps	17,866	(11,981)	5,885
Other	77	(13)	64
Carrying values of mortgages pledged under securitization in excess of tax values	(446)	22	(424)
Cumulative eligible capital property	(4,561)	300	(4,261)
Servicing liability	(5,006)	216	(4,790)
Fair value adjustments not deducted for tax purposes	(3,042)	(1,080)	(4,122)
Total	**$74,750**	**$4,050**	**$78,800**

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

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

19. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Risk Management

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

Interest Rate Risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company's exposure to the risk of changes in market interest rates relates primarily to the Company's mortgages accumulated for securitization.

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

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

The table below provides the financial impact that an immediate and sustained 100 basis point and 200 basis point increase and decrease in short-term interest rates would have had on the net income of the Company in 2019 and 2018.

	Decrease in interest rate[1]		Increase in interest rate	
	2019	**2018**	**2019**	**2018**
100 BASIS POINT SHIFT				
Impact on net income	**$5,909**	$4,816	**$(5,909)**	$(4,816)
200 BASIS POINT SHIFT				
Impact on net income	**$12,069**	$9,632	**$(11,818)**	$(9,632)

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

Credit Risk

Credit risk is the risk of loss associated with a counterparty's inability or unwillingness to fulfil 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, 2019, 94% (2018 – 96%) of the pledged mortgages were insured mortgages. See details in note 3. The Company's exposure is further mitigated by the relatively short period over which a mortgage is held by the Company prior to securitization.

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

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

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

Liquidity Risk and Capital Resources

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

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

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

Market Risk

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

Customer Concentration Risk

Placement fees and mortgage servicing income from one Canadian financial institution represent approximately 8.7% (2018 – 9.0%) of the Company's total revenue.

Fair Value Measurement

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

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

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

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

Valuation Methods and Assumptions

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

(a) Mortgages and Loan Investments

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

(b) Deferred Placement Fees Receivable

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

(c) Securities Owned and Sold Short

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

(d) Servicing Liability

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

(e) Other Financial Assets and Financial Liabilities

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

(f) Fair Value of Financial Instruments Not Carried at Fair Value

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

Carrying Value and Fair Value of Selected Financial Instruments

The fair value of the financial assets and financial liabilities of the Company approximates its carrying value, except for mortgages pledged under securitization, which has a carrying value of $31,995,424 (2018 – $30,567,036) and a fair value of $32,831,505 (2018 – $31,071,851); debt related to securitized mortgages, which has a carrying value of $32,245,793 (2018 – $30,781,007) and a fair value of $31,831,691 (2018 – $30,592,827); and senior unsecured notes, which have a carrying value of $374,025 (2018 – $174,829) and a fair value of $375,916 (2018 – $175,856). These fair values are estimated using valuation techniques in which one or more significant inputs are unobservable (Level 3).

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

2019	Level 1	Level 2	Level 3	Total
FINANCIAL ASSETS				
Mortgages accumulated for sale	—	34,010	—	34,010
Mortgage and loan investments	—	—	370,414	370,414
Interest rate swaps	—	29,970	—	29,970
Total financial assets	—	$63,980	$370,414	$434,394
FINANCIAL LIABILITIES				
Securities sold short	—	2,397,325	—	2,397,325
Interest rate swaps	—	1,870	—	1,870
Total financial liabilities	—	$2,399,195	—	$2,399,195

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

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, 2019, that was estimated using a valuation technique based on assumptions that are not fully supported by observable market prices or rates was approximately a loss of $4,300 (2018 – $4,000). 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 2019 and 2018, the Company did not have any transfers between levels.

The following table presents changes in the fair values, including realized losses of $74,832 (2018 – gains of $32,942) of the Company's financial assets and financial liabilities for the years ended December 31, 2019 and 2018, all of which have been classified as FVTPL:

	2019	**2018**
FVTPL mortgages	**(4,300)**	(4,000)
Securities sold short	**(8,270)**	5,822
Interest rate swaps	**2,915**	1,340
	$(9,655)	$3,162

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, 2019 and 2018. 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, 2019	**Investments**	**Unrealized loss recorded in income**	**Payment and amortization**	**Fair value as at December 31, 2019**
FINANCIAL ASSETS					
Mortgage and loan investments	**$188,666**	**$241,646**	**$(4,300)**	**$(55,598)**	**$370,414**

	Fair value as at January 1, 2018	**Investments**	**Unrealized loss recorded in income**	**Payment and amortization**	**Fair value as at December 31, 2018**
FINANCIAL ASSETS					
Mortgage and loan investments	$379,713	$44,294	$(4,000)	$(231,341)	$188,666

20. CAPITAL MANAGEMENT

The Company's objective is to maintain a capital base so as to maintain investor, creditor and market confidence and sustain future development of the business. Management defines capital as the Company's common share capital and retained earnings. FNFLP has a minimum capital requirement as stipulated by its bank credit facility. The agreement limits the debt under bank indebtedness together with the unsecured notes to four times FNFLP's equity. As at December 31, 2019, the ratio was 1.91:1 (2018 – 1.90:1). The Company was in compliance with the bank covenant throughout the year.

21. EARNINGS BY BUSINESS SEGMENT

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

	2019		
	Residential	Commercial	Total
REVENUE			
Interest revenue – securitized mortgages	661,081	216,639	877,720
Interest expense – securitized mortgages	(558,742)	(180,329)	(739,071)
Net interest – securitized mortgages	102,339	36,310	138,649
Placement and servicing	293,008	80,780	373,788
Mortgage investment income	59,256	25,414	84,670
Realized and unrealized gains on financial instruments	(5,332)	(4,323)	(9,655)
	$449,271	$138,181	$587,452
EXPENSES			
Amortization	7,023	790	7,813
Interest	59,452	18,248	77,700
Other operating	211,373	48,853	260,226
	$277,848	$67,891	$345,739
INCOME BEFORE INCOME TAXES	$171,423	$70,290	$241,713
Identifiable assets	28,535,288	9,120,529	37,655,817
Goodwill	—	—	29,776
Total assets	$28,535,288	$9,120,529	$37,685,593
CAPITAL EXPENDITURES	$4,113	$1,761	$5,874

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

"It is not easy to create a culture like First National's. We believe a flat organizational structure, careful recruitment, thorough onboarding, and bias for promoting from within have contributed greatly to workplace engagement and morale."

22. RELATED PARTY AND OTHER TRANSACTIONS

The Company has servicing contracts in connection with commercial mezzanine mortgages originated by the Company and subsequently sold to various entities controlled by a senior executive and shareholder of the Company. The Company services these mortgages during their terms at market commercial servicing rates. During the year, the Company originated $82,910 of new mortgages for the related parties. The related parties also funded several progress draws totalling $14,987 on existing mortgages originated by the Company. All such mortgages, which are administered by the Company, have a balance of $188,968 as at December 31, 2019 (December 31, 2018 – $121,556). As at December 31, 2019, three of the mortgages are secured by real estate in which the Company is also a subordinate mortgage lender.

A senior executive and shareholder of the Company has a significant investment in a mortgage default insurance company. In the ordinary course of business, the insurance company provides insurance policies to the Company's borrowers at market rates. In addition, the insurance company has also provided the Company with portfolio insurance at market premiums. The total bulk insurance premium paid by the Company in 2019 was $3,016 (2018 – $2,339), net of third-party investor reimbursement. The insurance company had also engaged the Company to service a portfolio of mortgages at market servicing rates. The portfolio had a balance of $1,625 as at December 31, 2018, but was fully paid down during the first quarter of 2019.

23. COMPARATIVE CONSOLIDATED FINANCIAL STATEMENTS

Certain comparative figures have been reclassified to conform to the current year's presentation.

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 Ethics and Conduct Policy, 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 Governance 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), Robert Mitchell and Robert Pearce

GOVERNANCE COMMITTEE

The Governance Committee's responsibilities include:

- Periodically assessing and making recommendations on the Company's approach to governance issues;
- Assisting in the development of governance policies, practices and procedures for approval by the Board of Directors;
- Reviewing conflicts of interest and transactions involving related parties of the Company; and
- Periodically reviewing the composition and effectiveness of the Board of Directors.

The Governance Committee consists of three directors, all of whom are independent for the purposes of National Instrument 58-101 – Disclosure of Corporate Governance Practices.

Committee Members
Barbara Palk (Chair), Duncan Jackman and Robert Pearce

BOARD OF DIRECTORS

STEPHEN SMITH

Stephen Smith, one of Canada's leading financial services entrepreneurs, is the Chairman, Chief Executive Officer and Co-founder of First National Financial Corporation. He has been an innovator in the development and utilization of various securitization techniques to finance mortgage assets, as well as a leader in the development and application of information technology in the mortgage industry.

Mr. Smith is Chairman of Canada Guarantee Mortgage Insurance Company, which he owns in partnership with Ontario Teacher's Pension Plan. He is Chairman and co-owner of Duo Bank of Canada, formerly Walmart Canada Bank. Mr. Smith is the largest shareholder in Equitable Bank, one of Canada's leading alternative lenders and the country's ninth-largest publicly traded bank. Mr. Smith is a member of the Board of Directors of the C.D. Howe Institute, E-L Financial Corporation Limited and the Canada Infrastructure Bank. He is also Chairman of Historica Canada, the producer of the Heritage Minutes and publisher of The Canadian Encyclopedia. In 2012, Mr. Smith received the Queen Elizabeth II Diamond Jubilee Medal for contributions to Canada.

In 2015, Queen's University announced the naming of the Stephen J.R. Smith School of Business at Queen's University, in honour of Mr. Smith and his historic $50 million donation to the school.

Mr. Smith holds a Bachelor of Science (Honours) in Electrical Engineering from Queen's University and a Master of Science in Economics from the London School of Economics.

MORAY TAWSE

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.

JOHN BROUGH

John Brough was President of both Torwest, Inc. and Wittington Properties Limited, real estate development companies, from 1998 to December 31, 2007, upon his retirement. Prior thereto, from 1996 to 1998, Mr. Brough was Executive Vice President and Chief Financial Officer of iSTAR Internet, Inc. Prior thereto, from 1974 to 1996, he held a number of positions with Markborough Properties, Inc., his final position being Senior Vice President and Chief Financial Officer, which position he held from 1986 to 1996. Mr. Brough is an executive with over 40 years of experience in the real estate industry. He is currently a director and Chairman of the Audit and Risk Committee of Kinross Gold Corporation, a director and Chairman of the Audit Committee and Lead Director of First National Financial Corporation, and a director and Chairman of the Audit Committee of Canadian Real Estate Investment Trust. He holds a Bachelor of Arts (Economics) from the University of Toronto and is a Chartered Professional Accountant and a Chartered Accountant. He is also a graduate of the Institute of Corporate Directors – Director Education Program at the University of Toronto, Rotman School of Management. Mr. Brough is a member of the Institute of Corporate Directors, Chartered Professional Accountants of Ontario and Chartered Professional Accountants of Canada.

DUNCAN JACKMAN

Duncan Jackman has been Chairman, President and Chief Executive Officer of E-L Financial Corporation, an investment and insurance holding company, since 2003. In 2003, he was also elected Chairman of the Board of The Empire Life Insurance Company. Mr. Jackman is also Chairman of Algoma Central Corporation, the largest Great Lakes bulk shipper, as well as Chairman and President of Economic Investment Trust Limited and United Corporations Limited, two Canadian listed closed-end funds. He also serves as a member of the Board of Directors of several other public and private companies. Mr. Jackman is a member of the Business Council of Canada and formerly served on the Economic Advisory Council to the Minister of Finance, Government of Canada. He is also Chair of the Patron's Council for Community Living Toronto, which provides support to thousands of individuals with an intellectual disability. Mr. Jackman graduated from McGill University in Montreal.

ROBERT MITCHELL

Robert Mitchell has been the 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 has an MBA from the University of Western Ontario and a Bachelor of Commerce (Finance) from the University of Calgary, and is a CFA charterholder. Mr. Mitchell sits on the board of Equestrian Canada.

BARBARA PALK

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 board of Crombie Real Estate Investment Trust, where she chairs the Human Resources Committee. Her previous boards include Ontario Teachers' Pension Plan, where she chaired the Investment Committee; TD Asset Management USA Funds Inc.; the Canadian Coalition for Good Governance, where she chaired the Governance Committee; Greenwood College School; the Investment Counselling Association of Canada; the Perimeter Institute; the Shaw Festival; UNICEF Canada; and Queen's University, where she was the Chair of the Board of Trustees. 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) in Economics from Queen's University, and has been named one of Canada's Top 100 Most Powerful Women (2004).

ROBERT PEARCE

Robert Pearce serves on the Board of Directors of Canada Guaranty Mortgage Insurance Company, First American Payment Systems, CPI Card Group and Duo Bank of Canada. Mr. Pearce spent 26 years with BMO Bank of Montreal, from 1980 to 2006, most recently holding the position of President and Chief Executive Officer, Personal and Commercial Client Group. He also served on the Board of Directors of Mastercard International from 1998 to 2006, and as Chairman of the Canadian Bankers' Association from 2004 to 2006. Mr. Pearce holds a Bachelor of Arts from the University of Victoria and an MBA from the University of British Columbia. Mr. Pearce brings to the Board over 30 years of operational and leadership experience in the financial services industry.

STAKEHOLDER INFORMATION

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INVESTOR RELATIONS WEBSITE

www.firstnational.ca

ANNUAL MEETING

May 5, 2020, 9:00 a.m. EDT
TMX Broadcast Centre
The Gallery
The Exchange Tower
130 King Street West
Toronto, Ontario

REGISTRAR AND TRANSFER AGENT

Computershare Investor Services Inc.,
Toronto, Ontario
1.800.564.6253

EXCHANGE LISTING AND SYMBOLS

Common shares: (TSX) FN
Class A Series 1 Preference Shares: (TSX) FN.PR.A
Class A Series 2 Preference Shares: (TSX) FN.PR.B

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Stikeman Elliott LLP, Toronto, Ontario

SENIOR EXECUTIVES OF FIRST NATIONAL FINANCIAL CORPORATION

Stephen Smith
Co-founder, Chairman and Chief Executive Officer

Moray Tawse
Co-founder and Executive Vice President

Jason Ellis
President and Chief Operating Officer

Robert Inglis
Chief Financial Officer

Scott McKenzie
Senior Vice President, Residential Mortgages

Jeremy Wedgbury
Senior Vice President, Commercial Mortgages

Hilda Wong
Senior Vice President and General Counsel

VANCOUVER

CALGARY

TORONTO

MONTREAL

HALIFAX