2020

ANNUAL REPORT

FIRST NATIONAL

FINANCIAL CORPORATION

Corporate Profile

First National Financial is Canada's largest non-bank mortgage lender. Founded in 1988, our mortgage loan solutions are used by hundreds of thousands of borrowers across Canada to purchase single-family, multi-unit and commercial properties. Customers choose us and independent mortgage brokers recommend us because of our service, technology advantages and broad range of competitive products.

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

342,252

Borrowers served by First National in 2020 across Canada, an increase of 10% from 2019.

1,211

The number of full-time First National employees at year end, reflecting 18% year-over-year growth in our workforce to meet customer needs.

$118.7 BILLION

Mortgages under administration (MUA) – the source of most of the Company's earnings – reached this milestone at year end 2020, a 7% increase over 2019.

$1.38 BILLION

Revenue in 2020 grew 4% to a new annual record, despite the dampening effect of lower interest rates.

$190.2 MILLION

Record net income in 2020 ($3.12 per share) reflected higher origination and wider mortgage spreads.

50%

The after-tax, Pre-Fair Market Value[1] return on shareholders' equity in 2020 demonstrates the efficiency of the First National business model.

$148.4 MILLION

Value of common share dividends declared in 2020, bringing the cumulative total to $1.5 billion ($25.80 per share) since the Company's initial public offering in 2006.

573%

Total shareholder return between our IPO in 2006 and December 31, 2020.

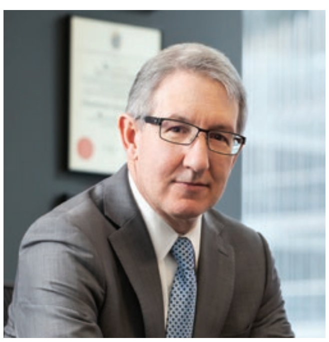
[1] Non-IFRS measure. See MD&A for more details.

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

HILDA WONG
Senior Vice President and
General Counsel

SCOTT MCKENZIE
Senior Vice President,
Residential Mortgages

JEREMY WEDGBURY
Senior Vice President,
Commercial Mortgages

Message to Shareholders

In the 33 years since First National began providing mortgages, Canada has faced several economic disruptions. Two of these – in 1990 and 2008 – were classified by the C.D. Howe Institute as the most severe since the mid-1950s. But 2020 was in a category all its own.

The global COVID-19 health crisis created unique and severe challenges for our country, society and the economy that are far from over. It is in this context that I compose my annual message to you.

As you will have noted from the opening pages of this report, First National took on these challenges and continued its record-setting pace of increased performance. Our key financial metrics – mortgages under administration (MUA), revenue and earnings – all reached record levels. Supported by strong earnings, the company increased its regular common share dividend payments by 7.7% and paid a special dividend of $0.50 per share. First National was also a job creator, adding 183 talented new employees to serve our customers and meet the demands of growth.

Do not let this performance deceive you. This past year tested our people, our culture and our technology like they have never been tested before.

Like other businesses, we had no advance warning of what was to come, although we did enter 2020 with a strong and proven foundation. In January, our budgets for the year were based on an optimistic, business-as-usual outlook supported by strong momentum in the form of new mortgage commitments. Our key concern was uncertain securitization margins as mortgage spreads had tightened entering 2020. Our outlook changed abruptly.

On March 11, 2020, the World Health Organization declared the outbreak of COVID-19 a global pandemic and, within days, states of emergency were declared across Canada that shut down non-essential businesses and activities. This prompted the federal government to announce various measures to aid the millions of Canadians who lost income. It also led the Bank of Canada to drop its key overnight rate by 150 basis points in less than a month and introduce a large quantitative easing program to ensure the financial system remained liquid.

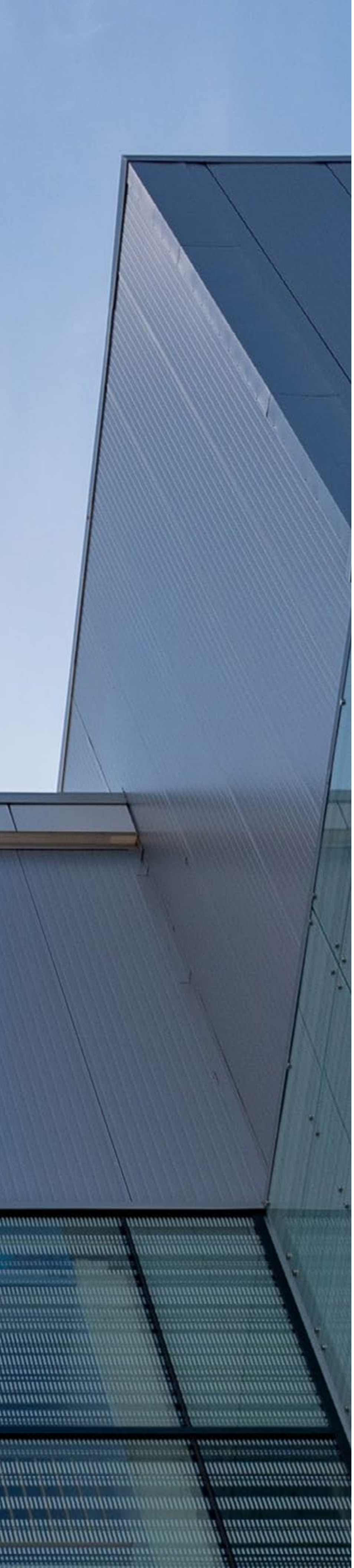
Fortunately, First National was deemed essential under government pandemic protocols, which allowed us to remain open through each subsequent lockdown. However, the pandemic was game changing for our business because it forced our entire workforce to relocate.

In March, we asked our employees across the country to work remotely from home so they could avoid exposure to the coronavirus. To support them, our IT team quickly secured and distributed computers to enable secure access to our systems. We also asked our employees to maintain the high levels of service our customers and partners in the mortgage broker community have come to expect and deserve. This was difficult in the weeks immediately following the first lockdown due to the extraordinary volume of requests for service and support.

The Bank of Canada's swift action also required equally swift action by our team to reset mortgage pricing and reassess market risk in our underwriting practices. Although First National only has direct credit exposure to $2.8 billion (2.4%) of MUA, these portfolios are risk managed.

For the first time ever, we also granted mortgage payment deferrals to borrowers who demonstrated financial need due to the pandemic. By May, we had approved mortgage payment deferrals for 33,800 borrowers, or 13.9% of single-family MUA eligible for this program. Providing deferrals enabled these borrowers to regain the ability to meet their financial obligations, but also required First National to make timely payments of interest and amortizing principal on the NHA-MBS securities it had issued. By year end, virtually no borrowers were on deferral, an outcome that speaks to the economic recovery and the creditworthiness of the company's borrowers.

"First National expects residential originations in 2021 to be comparable to the record set in 2020."



Lessons Learned, Advantages Validated

One cannot live through a crisis like this without seeing how a business and its markets stand up to extreme stress. From the experience of the past year, what we learned and validated about our business model can be summarized as follows.

Nothing stops the First National team from helping customers and supporting business partners.

Throughout the year, we saw numerous examples of extraordinary customer service. While at times we were challenged to meet the aggressive turnaround objectives we set for ourselves, the people of First National set a new benchmark for excellence under the most trying of circumstances.

Technology and innovation are more important to success than ever.

First National made a name for itself by developing an innovative non-bank, non-branch business model and creating MERLIN™, the first underwriting system of its kind serving the mortgage broker channel. These innovations were introduced three decades ago but found even greater relevance in 2020 as they allowed us to rise above capital market volatility and the pandemic lockdown to deliver reliable funding and seamless service even while working from home. Innovation continued in 2020 in the way we used our IT backbone in areas such as recruitment, training, and employee and customer communication.

Canadians need and value mortgage borrowers.

For the best advice and the most competitive mortgage offerings, the independent broker channel has always been unsurpassed, which is why its greatest proponent is First National. The pandemic also reinforced the channel's other advantage: convenience. Securing a First National mortgage with the help of a broker is far easier and, in this environment, safer than a physical visit to a traditional lender. These competitive benefits are reflected in the channel's market share gains over the years and particularly in 2020.

Not all recessions are equal.

In typical recessions, job losses lead to housing market correction. To date, this recession has rewritten the economic history books, as the housing market improved. We did not expect this last spring. Much to our surprise, in the second quarter of 2020, new single-family mortgage originations increased 15% or $600 million. In the third and fourth quarters, the results were even better, with growth of 42% or $1.7 billion and 65% or $2.3 billion, respectively. First National ended the year with single-family MUA of $83.6 billion, a new record. Economists and market commentators offered several explanations for the housing market's ability to withstand the gravitational pull of this recession. Among them: ultra-low interest rates, government income supports, and the idea that job losses were felt more acutely by those in part-time positions who are not typically home buyers. All of these reasons seem plausible, and with interest rates at current levels, it is possible that Canada can look forward to another year of strong housing market conditions. With all the usual caveats one needs to include with such a forward-looking statement, First National expects residential originations in 2021 to be comparable to the record set in 2020.

Our funding is as reliable as that of any financial institution.

As a non-bank, we do not take consumer deposits. However, our deep and diversified funding sources have allowed First National to lend in all economic conditions. Our ability to do so when other lenders pulled back served us well during the 2008 recession and again this past year. In our commercial business, this liquidity advantage supported annual origination growth of 23% in 2020, bringing our total commercial MUA to a record $35.1 billion. These numbers tell only part of the story. In the spring, investor demand for conventional commercial product weakened because of perceived market risk. First National seamlessly adjusted so that borrower needs were met with insured financings. Our ability to use conventional and insured products to address the needs of commercial borrowers across more of the credit spectrum makes us a valuable contributor in financing a wide variety of property assets, including apartments – our mainstay – as well as industrial, self-storage and office. In 2021, we expect further success in commercial markets because of our funding model and expertise.

Our culture is not defined by our office address.

With five locations across Canada, we have pride of place and believe corporate culture is more quickly formed and perpetuated in the office, which is why we look forward to returning when it is safe to do so. However, the ties that bind us run deeper than physical location. First National's culture is entrepreneurial, principled and family oriented. We have continued to place an emphasis on preserving our culture while the pandemic keeps us apart.

Best Place to Work

A sustainable financial services company is one where people build lifelong careers because the work they do is meaningful, challenging and rewarding, and the workplace environment is professional, stable and supportive. Based on our long-tenured workforce, First National is a sustainable company. We are striving to keep it that way as we grow by maintaining a flat organizational structure that is highly attuned to employee, customer and partner needs, offering effective human resources programs, and listening attentively to employees both formally and informally for improvement ideas.

We augment what we hear by inviting outside experts to independently survey our team. In 2020, First National once again – for the fourth consecutive year – achieved Great Places to Work® certification. This year, we qualified in two categories: 2020 Best Workplaces™ in Financial Services & Insurance and 2020 Best Workplaces™ in Ontario.

2021 Agenda

In business, it is not a good idea to take anything for granted. In a pandemic, it is not possible. We simply do not know how or when this health crisis will finally play out. That said, we are very positive about First National's prospects in 2021. I would encourage you to read the Outlook found in our MD&A to learn more.

Our business agenda for the coming year is not radically different than it was last year. We will strive to be better in every way. This is a tall order, but continuous improvement is part of our mindset. One key difference is that we will pursue growth for at least part of the year while maintaining our work-from-home stance. It is too early to say when we can safely return to our offices, but we continue to monitor health guidelines so we are prepared when that day arrives. We are scheduled to move into new Toronto headquarters in late 2021, a change of scenery that we look forward to for several reasons, including the fact that the building is new, fit-for-purpose and able to accommodate our future workforce needs.

Looking Forward

First National will build on the lessons learned last year and over the past 33 years to stay grounded and focused on what matters: relationships with customers, partners, employees and shareholders. Relationships are the key to success for our business. We must continue to find ways to offset the distancing effect of COVID-19 on all of these relationships. This will involve creative applications of technology but also timely, thoughtful communication and, in the case of customer relationships, value-added service and advice. In short, innovation built on the values we have created since our founding.

Thank You

Many people deserve credit for this past year's record performance, starting with our employees. Up and down the line, veterans and newcomers, the First National team is comprised of hard workers who are motivated to help our customers buy homes and finance commercial properties. Special thanks to the leaders of our company – including Jason Ellis, who added the title President of First National to his COO responsibilities just a few months before COVID-19 hit. My fellow directors also deserve credit for their stewardship during this most unusual period.

I reserve and offer my utmost thanks to our customers, business partners and fellow shareholders for your loyalty, patronage and confidence. We will do our best to reward you in 2021.

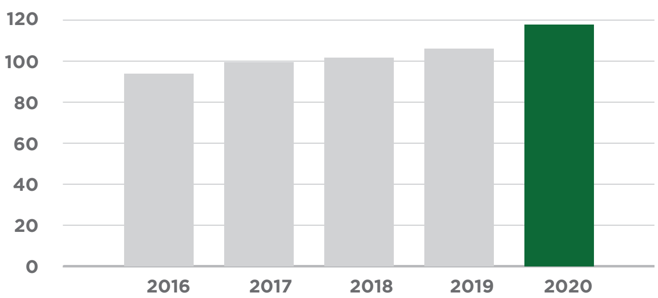
Yours sincerely,

STEPHEN SMITH
Chairman and Chief Executive Officer

March 2, 2021

MORTGAGES UNDER ADMINISTRATION
($ Billions)

5%
4-year compound annual growth

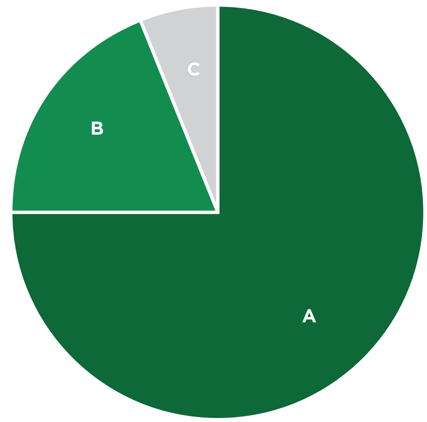


2020 MUA BY ASSET TYPE

A
75%
Insured

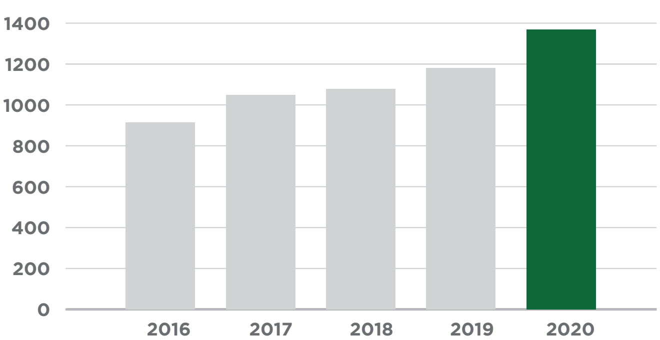
B
19%
Uninsured single-family residential

C
6%
Uninsured multi-residential and commercial



REVENUE
($ Millions)

7%
4-year compound annual growth



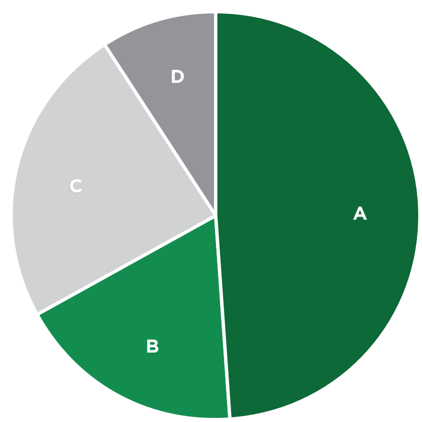
2020 REVENUE SOURCES PRIOR TO FAIR VALUE GAINS/LOSSES

A
49%
Institutional placements

B
18%
Net interest – securitized mortgages

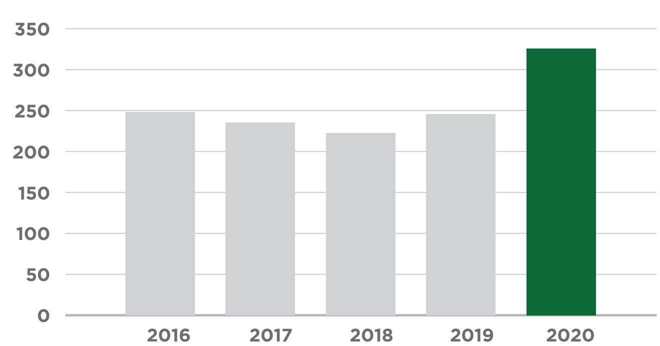
C
24%
Mortgage servicing

D
9%
Investment income



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

7%
4-year compound annual growth



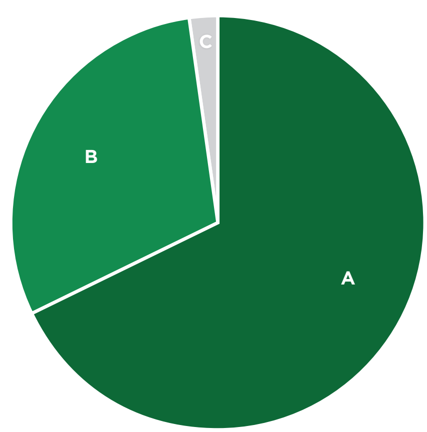
[1]Non-IFRS measure. See MD&A for more details.

2020 FUNDING SOURCES

A
68%
Institutional investors

B
30%
Securitization

C
2%
Internal



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 March 2, 2021. 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, 2020. 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 Income" 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 $118 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.

2020 RESULTS SUMMARY

Management is very pleased with the performance of the Company during 2020, particularly given widespread economic disruption that commenced with COVID-19-related employment loss. First National's employees worked from home throughout most of 2020, beginning in mid-March, and remained productive and efficient. Supported by a resilient housing market across Canada, the Company increased single-family origination 42% year over year. The commercial segment had excellent results given the economic environment and a challenging period for non-residential real estate. Commercial origination for the year increased by 23%. Total combined new origination was higher by 35% compared to 2019. Earnings were strong as the Company benefited from strong origination and wider mortgage spreads.

- MUA grew to $118.7 billion at December 31, 2020 from $111.4 billion at December 31, 2019, an increase of 7%; the growth from September 30, 2020, when MUA was $117.1 billion, was 5% on an annualized basis.

- Total new single-family mortgage origination was $19.2 billion in 2020 compared to $13.5 billion in 2019, an increase of 42%. The Company attributes this to an increasing market share in the mortgage broker distribution channel. The Company believes that the value of its long-time broker relationships and effective technology may have been a significant advantage during the 2020 pandemic. Commercial segment origination of $9.1 billion was 23% higher than the $7.4 billion originated in 2019. Overall new origination increased by 35% in 2020 compared to 2019.
- The Company took advantage of opportunities in the year to renew over $6.7 billion of single-family mortgages ($5.5 billion a year ago). For the commercial segment, renewals were similar at approximately $2.0 billion in each year.
- Revenue for 2020 increased by 4% to $1.38 billion from $1.33 billion in 2019. The increase was affected by changes in the fair market of financial instruments related to interest rate movements in both years. Excluding such amounts, revenue grew 8% to $1.45 billion in 2020 from $1.34 billion in 2019. This growth was largely a function of higher mortgage origination, which fuelled an increase in placement fee revenue of 62%.
- Income before income taxes increased by 7% to $258.7 million in 2020 from $241.7 million in 2019. The increase was affected by changing capital market conditions. Excluding the gains and losses related to financial instruments, the Company's earnings before income taxes and gains and losses on financial instruments ("Pre-FMV Income") for 2020 increased by 31% to $323.0 million from $247.1 million in 2019. The increase is largely the result of higher origination and wider mortgage spreads, which both had favourable impacts on placement fee revenue.

The Company's Board of Directors increased the regular monthly dividend from $1.95 to $2.10 per common share on an annualized basis effective with the dividend payable on December 15, 2020, and declared a special common share dividend in the amount of $0.50 per share, payable on December 15, 2020, to shareholders of record on November 30, 2020. This 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 (loss) for the period	Pre-FMV income for the period[1]	Net income (loss) per common share	Total assets
2020					
Fourth quarter	**$387,303**	**$69,123**	**$94,937**	**$1.13**	**$39,488,527**
Third quarter	**$373,760**	**$72,517**	**$99,644**	**$1.20**	**$38,314,904**
Second quarter	**$344,581**	**$50,844**	**$75,506**	**$0.84**	**$39,040,298**
First quarter	**$274,650**	**($2,255)**	**$52,921**	**($0.05)**	**$39,203,792**
2019					
Fourth quarter	$342,138	$48,993	$60,418	$0.80	$37,685,593
Third quarter	$362,833	$60,578	$79,816	$1.00	$37,249,143
Second quarter	$335,241	$44,164	$67,565	$0.72	$37,229,876
First quarter	$286,311	$23,478	$39,269	$0.38	$36,193,793

[1] This non-IFRS measure adjusts income before income taxes by eliminating 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 figures presented for 2019 have been restated to conform to 2020's presentation.

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. Recently MUA increased, and revenue followed. 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 Income, 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 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. Toward the end of 2018, economic worries resurfaced, interest rates fell and mortgage spreads widened by about 0.30%. This had a significant positive effect on the value of the Company's operations. In the first quarter of 2019, Pre-FMV Income was at its lowest in the two-year period prior to the COVID-19 pandemic, as tighter spread 2018-originated mortgages were securitized and placed. Combined with lower origination volumes than 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. To start 2020, COVID-19-related financial turmoil meant that the Company reported a small loss. In the final two quarters of 2020, the Company benefited from abnormally wide mortgage spreads, which were the result of the aftermath of the COVID-19-related financial crisis that began at the end of the 2020 first quarter. These spreads were the basis for growth in Pre-FMV Income in these quarters.

OUTSTANDING SECURITIES OF THE CORPORATION

At December 31, 2020, and March 2, 2021, the Corporation had 59,967,429 common shares; 2,887,147 Class A preference shares, Series 1; 1,112,853 Class A preference shares; 200,000 November 2024 senior unsecured notes; and 200,000 November 2025 senior unsecured notes outstanding.

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

($000s, except per share amounts)

	2020	2019	2018
For the year ended December 31, INCOME STATEMENT HIGHLIGHTS			
Revenue	**1,380,294**	1,326,523	1,181,510
Interest expense – securitized mortgages	**(708,162)**	(739,071)	(646,069)
Brokerage fees	**(159,018)**	(102,596)	(75,354)
Salaries, interest and other operating expenses	**(254,385)**	(243,143)	(232,670)
Add (deduct): realized and unrealized losses (gains) on financial instruments	**67,355**	9,655	(3,162)
Deduct: unrealized losses regarding mortgage investments	**(3,076)**	(4,300)	(4,000)
Pre-FMV Income[1]	**323,008**	247,068	220,255
Add (deduct): realized and unrealized gains (losses) on financial instruments excluding those on mortgage investments	**(64,279)**	(5,355)	7,162
Provision for income taxes	**(68,500)**	(64,500)	(60,990)
Net income	**190,229**	177,213	166,427
Common share dividends declared	**148,419**	144,421	171,407
PER SHARE HIGHLIGHTS			
Net income per common share	**3.12**	2.90	2.73
Dividends per common share	**2.47**	2.41	2.86
At year end BALANCE SHEET HIGHLIGHTS			
Total assets	**$39,488,527**	$37,685,593	$36,037,127
Total long-term financial liabilities	**$398,554**	$374,025	$174,829

Notes:

[1] Pre-FMV Income is not a recognized earnings measure under IFRS and does not have a standardized meaning prescribed by IFRS. Therefore, Pre-FMV Income may not be comparable to similar measures presented by other issuers. Investors are cautioned that Pre-FMV Income 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. The figures for 2019 and 2018 have been restated to conform to 2020's presentation.

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, 2020, MUA totalled $118.7 billion, up from $111.4 billion at December 31, 2019, an increase of 7%. The growth of MUA in the fourth quarter of 2020 from September 30, 2020, on an annualized basis, was 5%.

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 2020, the Company's single-family origination increased across the country. The Company believes this is the result of its strong broker relationship and technology, which have both been significant benefits in the pandemic period. All of the Company's sales offices experienced double-digit growth. In aggregate, the Company's single-family origination grew by 42% in 2020 compared to 2019. The commercial segment also had higher origination. Total volumes increased by 23% to $9.1 billion in 2020 compared to $7.4 billion in 2019, even though investor appetite for non-residential mortgages was lower than in the prior year, resulting in contraction in origination of the Company's uninsured products. Together, overall new origination for 2020 increased 35% 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.

Excalibur Mortgage Products

The Company originates 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. These mortgages generally have higher interest rates than prime mortgages. First National's relationships with mortgage brokers and its underwriting systems allow for cost effective origination of significant volumes. The product is 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. In early 2020, an agreement was entered into with another bank-sponsored conduit to provide additional funding for this product. The Excalibur relaunch was rolled out gradually, beginning in Ontario. Currently the program is open to include all Ontario brokers. In the third quarter of 2020, the Company began testing the product selectively in the BC region.

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 2019, the Company extended the term of the facility by one year such that the maturity is 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 senior unsecured notes, which are fully drawn during their term; (3) the three-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

In November 2020, the Company issued 200,000 2.961% Series 3 senior unsecured notes for a five-year term pursuant to a private placement under an offering memorandum. These notes add to the Company's 2019 issuance of 200,000 3.582% Series 2 senior unsecured notes. The net proceeds of both offerings, after broker commissions, were loaned to FNFLP. On settlement, the proceeds were used to pay down a portion of the indebtedness under the bank credit facility. In April 2020, the Company drew on the bank credit facility to repay all of the 4.01% $175 million Series 1 notes when they matured. Effectively in 2020, the new note issuance has increased the Company's medium-term debt by $200 million, such that it now stands at approximately $400 million.

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 Directors approval, and are redeemable at the discretion of the Company such that after each five-year term ending on March 31, 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). In February 2021, the Company indicated to shareholders that it would not be redeeming the shares and would be resetting the dividend rates for another five-year term. 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 (and 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%
2020	1.76%

The table shows a history of spread information. Generally, when this spread is wider, the Company can earn higher returns from its securitization activities, although funding spreads are also a variable in the profit equation. Between 2009 and 2019, liquidity issues at financial institutions created by the financial crisis diminished and the competition for mortgages increased such that spreads tightened in the 10-year period as shown above, falling to a low of 1.10% in the third quarter of 2018. Toward the end of the first quarter of 2020, fears of a global pandemic related to COVID-19 led to a dramatic and sudden decrease in bond yields as central banks cut overnight rates significantly. Credit spreads widened and the capital markets stopped functioning normally. In the second quarter, as financial systems began to normalize and markets began to recover, mortgage coupons remained elevated as other credit spreads, including those on NHA-MBS, narrowed. The resulting spreads on mortgages funded through NHA-MBS had positive impacts on 2020 results and have increased the profitability of the Company's securitization portfolio in future periods. In 2020, the Company originated and renewed for securitization purposes approximately $8.3 billion of single-family mortgages and $2.8 billion of multi-unit residential mortgages. In 2020, the Company issued approximately $8.1 billion of NHA-MBS pools.

The Company is subject to various regulations put in place by CMHC to control the amount of NHA-MBS that a single issuer can create. These rules include the amount of CMHC guarantees that is a requirement to issue a pool. Currently there is a tiered NHA-MBS guarantee fee pricing structure, such that any guarantees issued to one issuer over $9.0 billion of issuance have a higher price. The tiered limit of $9.0 billion remains unchanged for 2021. Late in 2020, CMHC announced that guarantee fees will be increased for NHA-MBS pools issued after January 1, 2021. The Company estimates the increase will translate into a 0.05% increase in annual cost of funding per year for its NHA-MBS program.

Canada Mortgage Bonds Program

The CMB program is an initiative where Canada Housing Trust ("CHT") issues securities to investors in the form of semi-annual interest-yielding five- and 10-year bonds. 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. Pursuant to the COVID-19 crisis, CHT announced that the 2020 CMB program would be increased from a target of $40 billion to $60 billion. For 2021, the Minister of Finance has reduced the authorized amount of new guarantees for CMB back to $40 billion.

KEY PERFORMANCE INDICATORS

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

- Earnings before income taxes and losses and gains on financial instruments, with the exception of any losses related to mortgage investments ("Pre-FMV Income"[1]); and
- Dividend payout ratio.

Beginning in 2012, the Company used Pre-FMV EBITDA as a key performance measure. This non-IFRS measure was used to adjust the Company's earnings by excluding gains and losses related to the fair value of financial instruments and adding back depreciation and amortization. The addbacks of amortization ended in 2016 when IPO-related intangible assets were fully amortized. Accordingly, effective January 1, 2020, the Company elected to simplify the non-IFRS measure it presents to adjust only for fair value-related gains and losses. This measure will be reported as "Pre-FMV Income". Measures prior to 2020 were restated in accordance with this revised calculation. Pre-FMV Income is not recognized under IFRS. However, management believes that Pre-FMV Income is a useful measure that provides investors with an indication of income normalized for capital-market fluctuations. Pre-FMV Income 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 Income may differ from other issuers and, accordingly, Pre-FMV Income may not be comparable to measures used by other issuers.

	QUARTER ENDED		YEAR ENDED	
($000s)	December 31, 2020	December 31, 2019	December 31, 2020	December 31, 2019
FOR THE PERIOD				
Revenue	**387,303**	342,138	**1,380,294**	1,326,523
Income before income taxes	**94,273**	66,593	**258,729**	241,713
Pre-FMV Income[1]	**94,937**	60,418	**323,008**	247,068
AT PERIOD END				
Total assets	**39,488,527**	37,685,593	**39,488,527**	37,685,593
Mortgages under administration	**118,723,990**	111,378,891	**118,723,990**	111,378,891

Note:
[1] This non-IFRS measure adjusts income before income taxes by eliminating 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 2019 comparative figures were revised to conform to the 2020 presentation.

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 Income.

Determination of Common Share Dividend Payout Ratio

	QUARTER ENDED		YEAR ENDED	
($000s)	December 31, 2020	December 31, 2019	December 31, 2020	December 31, 2019
FOR THE PERIOD				
Net income attributable to common shareholders	**68,465**	48,230	**187,383**	174,156
Total dividends paid or declared on common shares	**60,717**	58,968	**148,419**	144,421
Dividends paid or declared on common shares, excluding special dividend	**30,733**	28,984	**118,435**	114,437
Total common share dividend payout ratio	**89%**	122%	**79%**	83%
Regular common share dividend payout ratio(1)	**45%**	60%	**63%**	66%
After-tax Pre-FMV dividend payout ratio(2)	**45%**	66%	**50%**	64%

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 income 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, 2020, the common share payout ratio was 79% compared to 83% in 2019. However, in both 2020 and 2019, the Company declared a special dividend and 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 generally reflected in narrower or wider spreads in the future once the mortgages have been pledged for securitization. Accordingly, management does not consider these losses to affect its dividend payment policy. If the special dividends and gains and losses on financial instruments in the two years are excluded from the above calculations, the dividend payout ratio for 2020 would have been 50% compared to 64% in 2019.

The Company also paid $2.8 million of dividends on its preferred shares in 2020 compared to $3.1 million in 2019.

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. In general, originations are allocated from one funding source to another depending on different criteria, including type of mortgage and securitization limits, with an overall consideration 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, 2020, new origination volume increased from $21.0 billion to $28.3 billion, or about 35%, compared to 2019.

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 $36.9 billion of new originations and renewals in 2020, $11.0 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 $36.9 billion of new originations and renewals in 2020, $25.0 billion was placed with institutional investors.

For all institutional placements, 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 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 two mortgage originators 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, 2020	December 31, 2019	December 31, 2020	December 31, 2019
MORTGAGE ORIGINATIONS BY SEGMENT				
New single-family residential	**5,962**	3,624	**19,165**	13,523
New multi-unit and commercial	**2,723**	2,226	**9,112**	7,431
Sub-total	**8,685**	5,850	**28,277**	20,954
Single-family residential renewals	**1,648**	1,409	**6,668**	5,504
Multi-unit and commercial renewals	**558**	603	**1,962**	1,996
Total origination and renewals	**$10,891**	$7,862	**$36,907**	$28,454
MORTGAGE ORIGINATIONS BY FUNDING SOURCE				
Institutional investors – new residential	**4,618**	2,140	**13,067**	8,223
Institutional investors – renew residential	**1,211**	201	**3,929**	3,204
Institutional investors – multi/commercial	**2,182**	1,994	**8,023**	7,153
NHA-MBS/CMB/ABCP securitization	**2,547**	3,185	**11,036**	8,887
Internal Company resources/CMBS	**333**	342	**852**	987
Total	**$10,891**	$7,862	**$36,907**	$28,454
MORTGAGES UNDER ADMINISTRATION				
Single-family residential	**83,601**	80,709	**83,601**	80,709
Multi-unit residential and commercial	**35,123**	30,670	**35,123**	30,670
Total	**$118,724**	$111,379	**$118,724**	$111,379

Total new mortgage origination volumes increased in 2020 compared to 2019 by 35%. Single-family volumes increased by 42% and commercial segment volumes increased by 23% year over year. Management believes the increase in the single-family segment is due to its strong broker and investor relationships and its MERLIN™ technology and operating systems, which support physical distancing and have allowed the Company to continue to underwrite efficiently during the pandemic. Lower mortgage rates have also encouraged home purchasing across the country. In the commercial segment, the Company's expertise in underwriting multi-unit mortgages was fundamental to growth, and origination volumes grew by 23%. When combined with renewals, total production for both business segments increased by 30% from $28.5 billion in 2019 to almost $37 billion in 2020. Origination for direct securitization into NHA-MBS, CMB and ABCP programs remained a large part of the Company's strategy, with volume of $11.0 billion in 2020.

Net Interest – Securitized Mortgages

Comparing the year ended December 31, 2020, to the year ended December 31, 2019, “net interest – securitized mortgages” decreased by about 7% to $129.4 million from $138.6 million. The decrease was largely due to the consequences of the market disruption that accompanied the COVID-19 pandemic. In March 2020, the Bank of Canada cut overnight interest rates by 1.5%. The ensuing financial turmoil affected securitization margins in the first and second quarters. By the third quarter, financial market conditions had normalized. Even so, net interest was negatively impacted by the significant impact from the cost of indemnities payable to MBS debtholders when mortgages prepaid prior to the scheduled maturity date. The indemnities are calculated to make whole the debtholders who are assumed to reinvest the prepayment principal at risk-free reinvestment rates. With the recent decrease in interest rates, the cost of such indemnities has increased significantly. The Company calculates that because of the increase in indemnity costs, net securitization spread is lower by about $18.4 million. The Company’s prime ABCP programs suffered in the first two quarters of 2020 as the cost of funds reacted negatively to the financial turmoil produced by the pandemic such that profitability was decreased. The Excalibur securitization program had favourable results as the Company increased this portfolio and credit loss ratios were lower than expected.

Placement Fees

Placement fee revenue increased by 62% to $333.7 million from $205.5 million in the comparative year. The increase was the result of 59% year-over-year growth in residential mortgage volume with institutional investors. This growth was augmented by higher per unit placement fees, which resulted from the aftermath of the pandemic-related financial turmoil. As mortgage spreads widened beginning in the second quarter of 2020, the value of mortgages retained on the Company’s balance sheet increased as other credit spreads began to normalize. When the Company subsequently placed such origination, this value came through in the form of higher placement fees. Similar economics were evident in the commercial segment, where both volume and wider mortgage spreads led to increased placement fees.

Gains on Deferred Placement Fees

Gains on deferred placement fees revenue increased 179% to $32.4 million from $11.6 million. The gains related to multi-unit residential mortgages originated and sold to institutional investors. Volumes for these transactions increased by 40% from 2019, and mortgage spreads on commercial segment mortgages widened significantly year over year.

Mortgage Servicing Income

Mortgage servicing income increased 12% to $175.0 million from $156.7 million. This increase was largely attributable to the Company’s third-party underwriting business unit. Much like the Company’s experience in single-family origination, mortgage brokers referring mortgages to First National’s third-party customers have embraced the MERLIN™ technology. The Company believes the technology has been advantageous during the pandemic-related lockdown period and led to increased origination volumes.

Mortgage Investment Income

Mortgage investment income decreased 19% to $69.0 million from $84.7 million. The decrease was due primarily to the interest rate environment, as short-term rates fell significantly in March as the Bank of Canada cut its overnight rate by 1.5%. This started a steady reduction in the Company’s offered mortgage rates. The result was lower amounts of interest earned while mortgages are accumulated for securitization and sale on the balance sheet.

Realized and Unrealized Gains (Losses) on Financial Instruments

This financial statement line item typically consists of three primary 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, 2020	December 31, 2019	December 31, 2020	December 31, 2019
Gains (losses) on short bonds used for the economic hedging program	**114**	5,931	**(75,689)**	(8,269)
Gains (losses) on mortgages held at fair value	**924**	(700)	**(3,076)**	(4,300)
Gains (losses) on interest rate swaps	**(778)**	244	**11,410**	2,914
Net gains (losses) on financial instruments	**260**	5,475	**(67,355)**	(9,655)

In the first quarter of 2020, financial repercussions related to COVID-19 were very severe. With rapid unemployment and liquidity fears, the Bank of Canada reduced its overnight lending rate by 1.50%, and bond yields quickly fell as the fears of a global pandemic and recession increased. The lower yields had a significant impact on the Company's short bond positions and the Company recorded $66.4 million of losses in the first quarter of 2020 on the bonds the Company used to mitigate interest rate risk on single-family commitments. As the financial markets normalized after the first quarter, bond yields continued to decline, but at a slower pace. For the year, losses on account of short bonds totalled $75.7 million. In the fourth quarter, interest rates were less volatile and the impact on financial instruments was much less significant.

Brokerage Fees Expense

Brokerage fees expense increased 55% to $159.0 million from $102.6 million. This increase is explained by higher origination volumes of single-family mortgages for institutional investors, which increased by 59% year over year. Unit broker fees were generally consistent between 2020 and 2019; however, commercial segment fees and portfolio insurance costs did not grow at the same rate as single-family origination. These factors moderated the growth of the overall brokerage fee expenses.

Salaries and Benefits Expense

Salaries and benefits expense increased 22% to $143.5 million from $117.6 million. Salaries were higher as overall headcount increased by 18% (1,028 employees as at December 31, 2019, and 1,211 at December 31, 2020). The increase was also the result of $13.7 million of higher compensation earned by commercial sales staff and for increased bonus provisions pursuant to increased origination levels and Company profits earned in 2020. 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 decreased 32% to $53.2 million from $77.7 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 decreased from the prior year due to the significant decrease in short-term lending rates pursuant to the Bank of Canada's 1.5% rate cut in March 2020.

Other Operating Expenses

Other operating expenses increased by 20% to $57.6 million from $47.9 million. The primary change in other operating expenses was higher hedging costs, which increased $8.1 million between the years. The expense increased as 30-day interest rates moved down significantly relative to five- and 10-year bond yields, making it more expensive to borrow the short bonds that the Company uses to hedge interest rate exposure. Without these costs, other operating expenses increased by $1.6 million, reflecting costs to support the growth of the business and MUA, particularly information technology costs. Discretionary costs, including promotion, travel and entertainment, were lower as a result of the pandemic.

Income before Income Taxes and Pre-FMV EBITDA

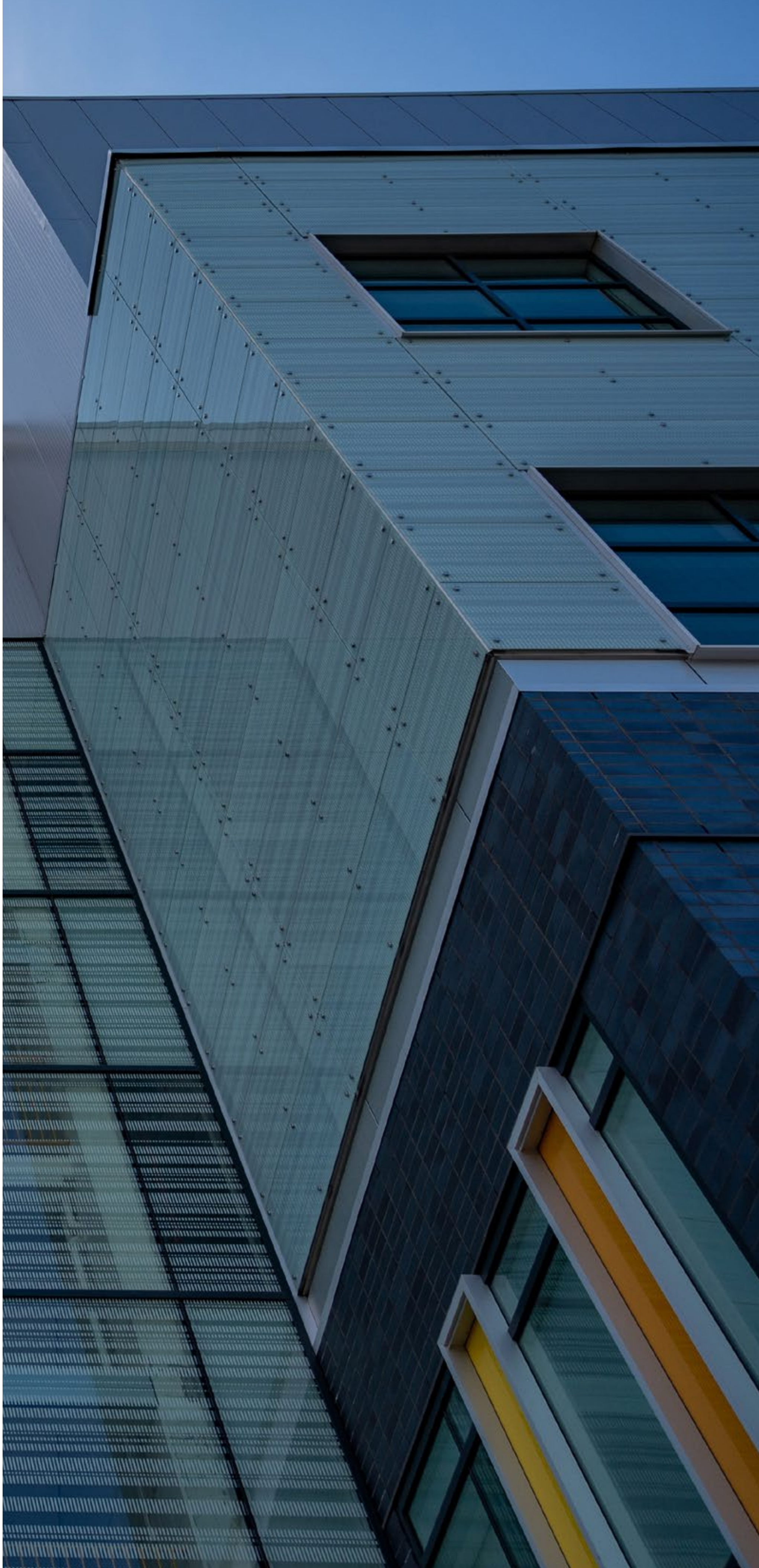
Income before income taxes increased by 7% to $258.7 million from $241.7 million in 2019. This increase was partially the result of changing capital markets. As described previously in this MD&A, the Company's results generally include gains or losses on account of financial instruments used to economically hedge residential mortgage commitments. In 2020, the Company recorded $64.3 million of losses on financial instruments (excluding $3.1 million of losses related to mortgage and loan investments). Comparatively, in 2019, the Company recorded $5.4 million of gains on financial instruments (excluding the impact of $4.3 million of losses related to mortgage and loan investments). The change in these values, excluding the losses on mortgage investments, accounted for a $58.9 million decrease in comparative income before income taxes. Pre-FMV Income, which eliminates the impact of such gains and losses on financial instruments, increased by 29% to $323.0 million from $251.3 million. This growth was largely the result of increased origination and higher per unit placement fee revenue, such that placement fee revenues net of brokerage fees increased by $71.8 million.

Income Tax Expense

The provision for taxes increased by 6% to $68.5 million from $64.5 million. The provision increased proportionately with net income before income taxes. The overall effective tax rate was slightly lower in 2020, as one of the provinces where the Company operates reduced its corporate tax rate during the year.

Other Comprehensive Income

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 or places the mortgage with an institutional investor. As the Company determined that these cash flow hedges were effective, the Company recorded $73.1 million of pre-tax net losses on such hedges in OCI in 2020. These losses would have been recorded as losses on financial instruments under the previous IFRS standard. In the year, the Company amortized a portion of these losses and a portion of opening accumulated OCI into regular earnings. In 2020, this amortization totalled $32.5 million. 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:

OPERATING BUSINESS SEGMENTS

FOR THE YEAR ENDED	**RESIDENTIAL**		**COMMERCIAL**	
($000s, except percent amounts)	December 31, 2020	December 31, 2019	December 31, 2020	December 31, 2019
Originations and renewals	**25,833,197**	19,026,919	**11,075,085**	9,427,357
Percentage change	***36%***		***17%***	
Revenue	**975,979**	1,008,013	**404,315**	318,510
Percentage change	***(3%)***		***27%***	
Income before income taxes	**141,085**	171,423	**117,644**	70,290
Percentage change	***(18%)***		***67%***	
AS AT	December 31, 2020	December 31, 2019	December 31, 2020	December 31, 2019
Identifiable assets	**28,945,884**	28,535,288	**10,512,867**	9,120,529
Mortgages under administration	**83,600,868**	80,709,370	**35,123,122**	30,669,521

RESIDENTIAL SEGMENT

Overall residential origination volumes including renewals increased by 36% between 2020 and 2019, while residential revenues decreased by 3%. Growth in origination did not translate into growth in revenue, due to the reduction in short-term interest rates that followed the Bank of Canada's overnight rate cut of 1.5%. This negatively affected interest revenue – securitized mortgages, as well as mortgage investment income. Net income before tax was affected by fair value-related revenues. Without the impact of these revenues, net income before tax increased to $205.4 million in 2020 from $176.8 million in 2019, or by 16%. This growth was largely the result of income from placement fees offset by lower securitization net interest margin as described earlier in this MD&A. Identifiable assets increased from December 31, 2019, as the Company increased its investment in mortgages pledged for securitization by about $700 million. This growth was offset by lower hedging-related assets.

COMMERCIAL SEGMENT

2020 commercial revenues increased by about 27% compared to 2019. This increase was the result of higher spread origination, which drove a 77% increase in placement fees. Interest revenue on the securitized mortgage portfolio grew by 13% year over year. Income before income taxes for this segment was not affected by fair-value considerations. This measure increased by 67% year over year. The increase is due to the higher placement fee revenues offset partially by higher compensation payable to the Company's commercial origination employees. Identifiable assets increased from those at December 31, 2019, as the Company increased its investment in mortgages pledged for securitization by $1.4 billion.

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, and once again in the COVID-19 crisis, when capital markets were disrupted and the demand for high-quality assets increased. As the Company's results in those years demonstrated, First National was able to attract 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 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, 2020, the Company had entered into repurchase transactions with financial institutions to borrow $1.4 billion related to $1.4 billion of mortgages held in "mortgages accumulated for sale or securitization" on the balance sheet.

At December 31, 2020, outstanding bank indebtedness was $682.8 million (December 31, 2019 – $797.8 million). Together with the unsecured notes of $399 million (December 31, 2019 – $375 million), this "combined debt" was used to fund $805.7 million (December 31, 2019 – $817.5 million) of mortgages accumulated for sale or securitization. At December 31, 2020, the Company's other interest-yielding assets included: (1) deferred placement fees receivable of $62.5 million (December 31, 2019 – $42.0 million) and (2) mortgage and loan investments of $213.3 million (December 31, 2019 – $370.4 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, decreased between December 31, 2019, and December 31, 2020, and now stands at $275.8 million (December 31, 2019 – $353.3 million). This represents a debt-to-equity ratio of approximately 0.48:1. This ratio is lower than the ratio of 0.63:1 at December 31, 2019. In general, the decrease was the result of repayments of $157 million of mortgage and loan investments, primarily related to the Company's commercial bridge loan portfolio. These proceeds were used to pay down the Company's debts. Despite some significant losses on account of financial instruments incurred in the year, the Company was able to increase earnings to offset such losses. The Company believes the ratio is appropriate given the nature of the assets which the debt is funding.

Since being approved as an issuer of NHA-MBS, the Company has funded the difference between the mortgages it uses to create NHA-MBS and the debt obligations it assumes upon issuance. In recent years, this requirement has generally been limited to mortgages in arrears where First National does not receive payments from the borrower but is obliged to pay the interest and amortizing principal on the NHA-MBS debt. However, due to the rapid rise in national unemployment pursuant to the COVID-19 pandemic, this funding requirement has increased as borrowers requested mortgage payment deferrals. In such situations, the Company determined to grant mortgage payment deferrals. Qualifying borrowers received three months of payment deferral. In cases of extended hardship, the Company provided a second three-month deferral after the initial deferral period ended. During this deferral period, a portion of such mortgages ceased to amortize and interest otherwise payable was capitalized to the principal of the mortgage. The three mortgage default insurers approved these steps, permitting the deferrals to occur without any impact on subsequent claims under the mortgage insurance policies. In turn, First National has been required to make "timely payments" on the NHA-MBS securities. This means that despite not receiving payments from borrowers on the mortgages that support the NHA-MBS, the Company has been required to pay the interest and amortizing principal on the debt. In effect, the Company de-leveraged its balance sheet by paying off the debt while the related mortgages did not as amortize as quickly. At December 31, 2020, the Company estimates that it had reduced its NHA-MBS debt by approximately $64 million because of the impact of deferred payments. This has been funded by the Company's available cash resources. Management believes that, at its peak, the Company granted deferrals to as many as 14% of its single-family borrowers. There have been no significant deferral requests granted to the multi-family segment of borrowers. The Company has significant credit lines and prime mortgage assets that continue to be liquid in turbulent economic times. Such facilities will provide the cash needed to fund this investment in "timely payments". For non-securitized MUA, the Company's institutional investors will be required to fund any deferred payments which First National grants to borrowers in that investor's portfolio. The Company's current deferral program ended on September 30, 2020. At December 31, 2020, there were virtually no mortgages on deferral.

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 before long-term financing. The banking syndicate has provided credit facilities to partially fund these investments. As these investments return cash, it will be used to pay down this bank indebtedness.

The syndicate has also provided credit to finance a portion of the Company's deferred placement fees receivable and the origination costs associated with securitization, as well as other miscellaneous longer-term financing needs.

A portion of the Company's capital has been employed to support its ABCP and NHA-MBS programs, primarily to provide credit enhancements as required by rating agencies. The most significant portion of cash collateral is the investment made on behalf of the Company's ABCP programs. As at December 31, 2020, the investment in cash collateral was $88.2 million (December 31, 2019 – $83.6 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 June 30, 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, 2020, the Company had over $1.1 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, 2020, the Company had entered into $0.6 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, 2020, the aggregate notional value of these swaps, maturing between June 2021 and September 2026, was $99.0 million. During the 2020 year, the value of these swaps increased by $11.4 million.

As described above, the Company employs various strategies to reduce interest rate risk. In the normal course of business, the Company also takes on 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 ultimate date of placement or securitization. If credit spreads widen during this holding period, this is unfavourable for the Company. It means that the Company cannot fund the mortgages originated with a funding source as effectively as originally intended. Despite entering into effective interest rate hedges, the Company's exposure to credit spreads will remain. This risk is inherent in the Company's business model and the Company believes it cannot be economically hedged. As at December 31, 2020, the Company had various exposures to changing credit spreads. In particular, in mortgages accumulated for sale or securitization, there were approximately $2.2 billion of mortgages that were susceptible to some degree of changing credit spreads.

“A significant portion of First National’s business model consists of the origination and placement or securitization of financial assets.”

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, because of the Company’s business model. 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, 2020, the Company purchased new computer equipment and software and made leasehold improvements. In the long term, the Company expects capital expenditures on fixed assets will be approximately $6.0 million annually, but will likely be higher in 2021 as the Toronto office moves its premises and invests in new leasehold improvements.

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	46,926	7,931	20,152	18,152	691

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The Company prepares its financial statements in accordance with IFRS, which requires management to make estimates, judgements and assumptions that management believes are reasonable based upon the information available. These estimates, judgements 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, 2020. 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 year ended December 31, 2020, continue to be consistent with those used for the year ended December 31, 2019, and the quarters ended September 30, June 30 and March 31, 2020.

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. A portion of the bonds sold short are designated as an effective hedge, and accordingly, 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 judgement. 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 $0.7 million for 2020.

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, 2020, 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, 2020.

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, 2020, and that no material weaknesses have been identified in the Company's internal control over financial reporting as of December 31, 2020. No changes were made in the Company's internal controls over financial reporting during the year ended December 31, 2020, 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 and 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.

It became clear to the Company in mid-March 2020 that COVID-19 was highly contagious and the Company executed its business continuity plan. In this case, the plan called for a "working from home" contingency. Within the first month, most of the Company's staff across the country transitioned to working from home. The COVID-19 crisis has been the cause of significant unemployment across the country and widespread economic hardship. During the duration of this crisis, the probability of the risks listed above having a negative impact on the Company has increased. Related losses could be material.

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, that 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 March 2, 2021, 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

2020 results exceeded management’s expectations. Single-family origination increased by 42% from the comparative volume in 2019, and commercial segment origination increased by 23% despite the pandemic-related slowdown in demand for uninsured commercial product. With COVID-19-related uncertainties still widespread, it is difficult to look too far ahead. However, with the results of the last three quarters of 2020 and a window on the first quarter of 2021, management is very positive about the 2021 fiscal year. The expectation for the next year includes: residential origination comparable to 2020, commercial segment success in growing origination, and continued employee productivity from the Company’s work-from-home strategy. During 2020, the value of First National’s business model was demonstrated. By designing systems that do not rely on face-to-face interactions, the Company’s business practices resonated with mortgage brokers and borrowers alike during the pandemic period. The commercial segment benefited from reduced competition, and First National increased its market share while earning wider spreads. With the expected distribution of vaccines across the nation, the economic effects of COVID-19 will hopefully diminish. However, the return to normalcy is certainly some months away. Management believes it will continue to have an advantage over traditional bank origination channels, which have been faced with disruption during the pandemic. First National expects that goodwill with its broker partners and customers created during the past nine months will persist through 2021. On the funding side, there continues to be strong demand from institutional investors as a result of the substantial amount of liquidity in the financial system. Securitization markets have normalized after a period of disruption at the beginning of the crisis.

While it is not early in the crisis, there is still significant uncertainty about its duration and the extent of repercussions. The outbreak of COVID-19 has resulted in governments worldwide enacting emergency measures to combat the spread of the virus. These measures, which include the implementation of travel bans, self-imposed quarantine periods and physical distancing, have caused material disruption to businesses globally, resulting in an economic recession. Global equity markets have experienced significant volatility. Governments and central banks have reacted with significant monetary and fiscal interventions designed to stabilize economic conditions. The duration and impact of the COVID-19 outbreak is unknown at this time, as is the long-term efficacy of the government and central bank interventions. It is not possible to reliably estimate the length and severity of these developments and the impact on the financial results and condition of the Company and its operating subsidiaries in future periods.

When management reported for the second quarter, the nature of deferred mortgage payments and the need for cash resources to fund these assets was described. As of May 11, 2020, the Company had approved mortgage payment deferrals for approximately 13.9% of the Company's single-family mortgages under administration eligible for such an approval. On September 30, 2020, the Company ended its deferral program, such that by the end of 2020, there were virtually no mortgages on deferral.

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 $34 billion portfolio of mortgages pledged under securitization and $83 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
March 2, 2021

Independent Auditor's Report

To the Shareholders of First National Financial Corporation

REPORT ON THE AUDIT OF THE CONSOLIDATED FINANCIAL STATEMENTS

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, 2020 and December 31, 2019, 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, 2020 and December 31, 2019, 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.

KEY AUDIT MATTERS

Key audit matters are those matters that, in our professional judgement, were of most significance in the audit of the financial statements of the current period. These matters were addressed in the context of the audit of the financial statements as a whole, and in forming the auditor's opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the *Auditor's responsibilities for the audit of the financial statements* section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying financial statements.

Measurement of Estimated Credit Losses

As more fully described in Note 2 and Note 3 to the financial statements, the Company is exposed to credit risk on its mortgage assets. In 2020 the Company has recorded an allowance for credit losses of $862 thousand. The Company manages credit risk by employing underwriting policies and procedures designed to minimize exposure to credit losses, and by acquiring insurance against borrower default on substantially all its mortgages [93% were insured as at December 31, 2020]. The remaining residual credit risk is related to $2.5 billion of uninsured mortgages, which are primarily conventional prime single-family. The Company's expected credit loss ["ECL"] impairment analysis considers a range of possible outcomes supported by past loss events, current conditions and an expectation of future possible outcomes.

The allowance for credit losses was identified as a key audit matter due to the high estimation uncertainty in determining the probability of default and loss given default assumptions. Management judgement was involved in selecting appropriate values for these critical assumptions, which in the event of a credit loss includes estimates of the amounts recoverable from underlying collateral. In forming their judgement, management had to both make an assessment of the effectiveness of their credit management strategies in minimizing future credit losses as well as make a forecast of possible future economic conditions and consider the impact of each on their critical assumptions. Variations in the key assumptions and judgements described can have a material effect on the measurement of ECL.

We obtained an understanding of management's controls over exposure to credit risk, including mortgage underwriting policies and processes used to assess borrower capacity, income verification, creditworthiness and collateral. We tested the operating effectiveness of these controls by assessing for a sample of mortgages originated and funded, compliance with management's underwriting policy and processes and eligibility, when arranged, for insurance against borrower default based on criteria of the mortgage default insurer.

For the purpose of auditing the allowance for credit losses, among other procedures:

- We tested the accuracy of the Company's historic default and write-off data and evaluated management's ECL impairment analysis, by obtaining the Company's historical data, corroborated by data from independent sources, to develop a range for the estimated ECL on the uninsured portfolio of mortgages held at amortized cost
- We compared our range to management's estimate of allowance for credit losses
- We also assessed the adequacy of the Company's disclosures on the management of credit risk.

Fair Value Measurement of Mortgage and Loan Investments

As more fully described in Note 6 to the financial statements, the Company held a portfolio of mortgage and loan investments classified as fair value through profit and loss with a balance of $213 million. The mortgage and loan investments are measured at management's best estimate of fair value, with changes in fair value recognized in income. A fair value loss of $3 million was recorded in income during the current year.

Auditing the valuation of mortgage and loan investments required judgement. The fair value of these assets is based on non-observable inputs. As these mortgages do not conform to conventional mortgage lending, there are few active quoted markets available to determine the fair value of these assets. Management estimates fair value using significant assumptions which include, among others, 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. These inputs give rise to estimation uncertainty and judgement in determining the fair value of these assets. Where the assets are in default, the valuation is highly dependent on the valuation of the underlying real property, which is subject to estimation uncertainty.

To test the valuation of mortgage and loan investments, among other procedures,

- We performed an independent assessment of the borrower's credit quality for a sample of performing and non-performing mortgage and loan investments to evaluate the estimate of net realizable value.

- For a sample of mortgage and loan investments, we involved our valuation specialists to assist in the assessment of fair value by performing an independent valuation of the underlying collateral using independent market data.
- We also assessed the adequacy of the Company's disclosures related to the fair value measurement of these mortgage and loan investments, including categorization in the fair value hierarchy.

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 judgement 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 Company's 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.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

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
March 2, 2021

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

As at December 31

(in thousands of Canadian dollars)	Notes	2020	2019
ASSETS			
Restricted cash	3	**669,219**	681,596
Cash held as collateral for securitization	3	**88,206**	83,587
Accounts receivable and sundry		**119,531**	131,042
Mortgages accumulated for sale or securitization	5	**2,250,519**	1,918,581
Mortgages pledged under securitization	3	**34,137,421**	31,995,424
Deferred placement fees receivable	4	**62,535**	42,046
Mortgage and loan investments	6	**213,301**	370,414
Securities purchased under resale agreements	15	**1,884,811**	2,414,835
Other assets	7	**62,984**	48,068
Total assets		**$39,488,527**	$37,685,593
LIABILITIES AND EQUITY			
Liabilities			
Bank indebtedness	9	**682,832**	797,758
Obligations related to securities and mortgages sold under repurchase agreements	15	**1,418,445**	1,072,062
Accounts payable and accrued liabilities	16	**185,772**	149,906
Securities sold short	14	**1,888,049**	2,397,325
Debt related to securitized mortgages	10	**34,265,504**	32,245,793
Senior unsecured notes	12	**398,554**	374,025
Income taxes payable	18	**11,470**	4,764
Deferred income tax liabilities	18	**67,100**	82,300
Total liabilities		**$38,917,726**	$37,123,933
Common shares	17	**122,671**	122,671
Preferred shares	17	**97,394**	97,394
Retained earnings		**383,993**	345,029
Accumulated other comprehensive loss		**(33,257)**	(3,434)
Total equity		**570,801**	561,660
Total liabilities and equity		**$39,488,527**	$37,685,593

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	2020	2019
REVENUE			
Interest revenue – securitized mortgages		**837,576**	877,720
Interest expense – securitized mortgages		**(708,162)**	(739,071)
Net interest – securitized mortgages	3	**129,414**	138,649
Placement fees		**333,696**	205,451
Gains on deferred placement fees	4	**32,365**	11,619
Mortgage investment income	6	**69,033**	84,670
Mortgage servicing income		**174,979**	156,718
Realized and unrealized losses on financial instruments	19	**(67,355)**	(9,655)
		$672,132	$587,452
EXPENSES			
Brokerage fees		**159,018**	102,596
Salaries and benefits		**143,503**	117,575
Interest		**53,246**	77,700
Other operating		**57,636**	47,868
		$413,403	$345,739
Income before income taxes		**258,729**	241,713
Income tax expense	18	**68,500**	**64,500**
Net income for the year		**$190,229**	$177,213
EARNINGS PER SHARE			
Basic	17	**3.12**	2.90

See accompanying notes

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Years ended December 31

(in thousands of Canadian dollars)	Notes	2020	2019
NET INCOME FOR THE YEAR		**190,229**	177,213
OTHER COMPREHENSIVE INCOME (LOSS) ITEMS THAT MAY BE SUBSEQUENTLY RECLASSIFIED TO INCOME			
Net losses from change in fair value of cash flow hedges		**(73,147)**	(25,118)
Reclassification of net losses to income		**32,524**	24,700
		(40,623)	(418)
Income tax recovery	18	**10,800**	100
Total other comprehensive loss		**(29,823)**	(318)
Total comprehensive income		**$160,406**	$176,895

See accompanying notes

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, 2020	**122,671**	**97,394**	**345,029**	**(3,434)**	**561,660**
Net income for the year	**—**	**—**	**190,229**	**—**	**190,229**
Other comprehensive loss	**—**	**—**	**—**	**(29,823)**	**(29,823)**
Dividends paid or declared	**—**	**—**	**(151,265)**	**—**	**(151,265)**
BALANCE AS AT DECEMBER 31, 2020	**$122,671**	**$97,394**	**$383,993**	**$(33,257)**	**$570,801**

	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

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31

(in thousands of Canadian dollars)	2020	2019
OPERATING ACTIVITIES		
Net income for the year	190,229	177,213
Add (deduct) items		
Deferred income taxes	(4,400)	3,600
Non-cash portion of gains on deferred placement fees	(31,320)	(11,176)
Decrease (increase) in restricted cash	12,377	(104,500)
Net investment in mortgages pledged under securitization	(2,077,042)	(1,403,327)
Net increase in debt related to securitized mortgages	1,954,756	1,439,725
Securities purchased under resale agreements, net	530,024	(226,686)
Securities sold short, net	(621,315)	258,081
Amortization of deferred placement fees receivable	10,831	10,714
Amortization of property, plant and equipment	7,660	7,813
Unrealized losses (gains) on financial instruments	63,082	(43,200)
	34,882	108,257
Net change in non-cash working capital balances related to operations	(285,841)	350,440
Cash provided by (used in) operating activities	$(250,959)	$458,697
INVESTING ACTIVITIES		
Additions to property, plant and equipment	(3,585)	(5,874)
Investment of cash held as collateral for securitization	(4,619)	(7,673)
Investment in mortgage and loan investments	(817,101)	(1,142,162)
Repayment of mortgage and loan investments	971,138	956,114
Cash provided by (used in) investing activities	$145,833	$(199,595)
FINANCING ACTIVITIES		
Dividends paid	(150,621)	(147,220)
Obligations related to securities and mortgages sold under repurchase agreements	346,383	(190,333)
Issuance of senior unsecured notes	199,290	199,040
Repayment of matured senior unsecured notes	(175,000)	—
Cash provided by (used in) financing activities	$220,052	$(138,513)
Net decrease in bank indebtedness during the year	114,926	120,589
Bank indebtedness, beginning of year	(797,758)	(918,347)
Bank indebtedness, end of year	$(682,832)	$(797,758)
SUPPLEMENTAL CASH FLOW INFORMATION		
Interest received	999,551	1,031,267
Interest paid	735,830	779,504
Income taxes paid	66,194	52,154

Notes to Consolidated Financial Statements

[in thousands of Canadian dollars, unless otherwise indicated]

December 31, 2020 and 2019

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 $118 billion in mortgages under administration as at December 31, 2020, 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 March 2, 2021.

[B] BASIS OF CONSOLIDATION

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

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

The Company did not consolidate, in its financial statements, three SPEs over which the Company does not have control. The SPEs are sponsored by third-party financial institutions which acquire assets from various sellers including mortgages from the Company. The Company earns interest income from the retained interest related to these mortgages. As at December 31, 2020, the Company recorded, on its consolidated statements of financial position, its portion of the assets of the SPEs amounting to $1,565 million [2019 – $1,275 million]. The Company also recorded, in its consolidated statements of income, interest revenue – securitized mortgages of $51.1 million [2019 – $31.4 million] and interest expense – securitized mortgages of $39.2 million [2019 – $27.4 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.

The global pandemic related to an outbreak of COVID-19 has cast additional uncertainty on the assumptions used by management in making its judgements and estimates. Governments and central banks have reacted with significant monetary and fiscal interventions designed to stabilize economic conditions. The duration and impact of the COVID-19 outbreak is unknown at this time, as is the efficacy of the government and central bank interventions. It is not possible to reliably estimate the length and severity of these developments and the impact on the consolidated financial results and condition of the Company and its operating subsidiaries in future periods. Given that the full extent of the impact that COVID-19, including government and/or regulatory responses to the outbreak, will have on the Canadian economy and the Company's business is highly uncertain and difficult to predict at this time, there is a higher level of uncertainty with respect to management's judgements and estimates related to the fair value of mortgage and loan investments and the amount of expected credit losses for uninsured residential mortgages.

[D] SIGNIFICANT ACCOUNTING POLICIES

FINANCIAL INSTRUMENTS

The Company accounts for its financial assets and liabilities in accordance with IFRS 9, *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. While mortgages in these two stages are not considered to be impaired, 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 a specific 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 judgement.

Hedge Accounting

The Company applies 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.

LEASES

The Company measures right-of-use assets at cost. The right-of-use assets are subsequently amortized using the straight-line method. The right-of-use assets are also subject to impairment. Lease liabilities are calculated using the present value of future lease payments, discounted at the Company's incremental borrowing rate. After the commencement date, the amount of lease liabilities is increased to reflect the accretion of interest and reduced for the lease payments made.

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 standard.

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 Company'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 which the Company uses to calculate deferred placement fees. Since quoted prices are generally not available for retained interests, the Company estimates its value based on the net present value of future expected cash flows, calculated using management's best estimates of key assumptions related to expected prepayment rates and discount rates commensurate with the risks involved. The Company earns the related servicing fees over the term of the mortgages on an effective yield basis.

INCOME TAXES

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

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

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

EARNINGS PER COMMON SHARE

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

3. MORTGAGES PLEDGED UNDER SECURITIZATION

The Company securitizes residential and commercial mortgages in order to raise debt to fund these mortgages. Most of these securitizations consist of the transfer of fixed and floating rate mortgages into securitization programs, such as ABCP, NHA-MBS and CMB. 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, 2020, the cash held as collateral for securitization was $88,206 [2019 – $83,587].

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

2020	Carrying amount of securitized mortgages ($)	Carrying amount of associated liabilities ($)
Securitized mortgages	**33,827,022**	**(34,231,557)**
Capitalized amounts related to hedge accounting	**125,581**	**(108,372)**
Capitalized origination costs	**184,818**	**—**
Debt discounts	**—**	**74,425**
	34,137,421	**(34,265,504)**
Add		
Principal portion of payments recorded in restricted cash	**612,742**	**—**
	34,750,163	**(34,265,504)**

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 held in restricted cash	623,253	—
	32,618,677	(32,245,793)

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

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

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

	2020	2019
OPENING BALANCE, JANUARY 1	**175,702**	169,453
Add: new origination costs capitalized in the year	**95,849**	85,421
Less: amortization in the year	**(86,733)**	(79,172)
ENDING BALANCE, DECEMBER 31	**$184,818**	$175,702

During the year ended December 31, 2020, the Company invested in mortgages that were transferred into the securitization vehicles with principal balances as at December 31, 2020 of $7,638,054 [2019 – $7,076,837].

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

2021	4,823,976
2022	5,910,797
2023	6,111,016
2024	5,636,441
2025 and thereafter	11,344,792
	$33,827,022

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

	2020	2019
ARREARS DAYS		
31 to 60	**4,555**	3,098
61 to 90	**1,946**	416
Greater than 90	**4,050**	4,464
	$10,551	$7,978

All the mortgages pledged under securitization in arrears are insured, except for nine mortgages which are uninsured and have a total principal balance of $2,572 as at December 31, 2020 [2019 – five mortgages, $874]. The Company's exposure to credit loss is limited to uninsured mortgages with principal balances totalling $2,312,549 [2019 – $1,975,154], 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. The Company has provided an allowance of $862 for the year ended December 31, 2020 [2019 – $214].

In order to assist its borrowers during the COVID-19 pandemic, in the first quarter of 2020, the Company started providing up to three months of payment deferrals to all single-family mortgagors applying for payment relief because of temporary hardship resulting from the pandemic. In the second and third quarters, the Company granted extensions to the original three months period to qualified borrowers based on additional due diligence. The payment deferral program ended September 30, 2020. Interest continues to accrue on these mortgages and the interest otherwise collectible is capitalized to the mortgage's principal. As the deferral is provided temporarily in keeping with a larger industry wide relief program, the Company does not consider these mortgages to be in arrears for ECL disclosure purposes. As at December 31, 2020, the Company had permitted $58,996 of payment deferrals related to $4,053,078 of mortgages pledged under securitization. A small portion of this amount has amortized down during the year as the affected mortgages have matured, refinanced or resumed regular payments such that the deferred payment balance are being repaid over the amortization of the mortgage. As at February 26, 2021, the Company had permitted $55,495 of payment deferrals related to $3,926,611 of mortgages pledged under securitization.

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 consolidated statements of income but is expected to be minimal.

During the year ended December 31, 2020, $3,461,154 [2019 – $2,419,508] of mortgages were placed with institutional investors, which created gains on deferred placement fees of $32,365 [2019 – $11,619]. Cash receipts on deferred placement fees receivable for the year ended December 31, 2020 were $13,008 [2019 – $12,655].

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

2021	15,013
2022	12,842
2023	10,997
2024	9,229
2025 and thereafter	22,423
	$70,504

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:

	2020	**2019**
Mortgages accumulated for securitization	**2,200,484**	1,884,571
Mortgages accumulated for sale	**50,035**	34,010
	$2,250,519	$1,918,581

The Company's exposure to credit loss is limited to $216,667 [2019 – $212,736] of principal balances of uninsured mortgages within mortgages accumulated for securitization, before consideration of the value of underlying collateral. As at December 31, 2020, 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 $3,076 [2019 – $4,300] for the year ended December 31, 2020.

The following table discloses the composition of the Company's portfolio of mortgage and loan investments by geographic region as at December 31, 2020:

Province/Territory	Portfolio balance	Percentage of portfolio
Alberta	**8,531**	4.00
British Columbia	**20,224**	9.48
Manitoba	**7,021**	3.29
New Brunswick	**180**	0.08
Newfoundland and Labrador	**290**	0.14
Nova Scotia	**3,744**	1.76
Nunavut	**74**	0.04
Ontario	**144,682**	67.82
Quebec	**94**	0.04
Saskatchewan	**28,088**	13.17
Yukon	**164**	0.08
Prince Edward Island	**209**	0.10
	$213,301	100.00%

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

	2020	2019
ARREARS DAYS		
31 to 60	**5,363**	5,016
61 to 90	**112**	4
Greater than 90	**33,666**	34,235
	$39,141	$39,255

The portfolio contains $5,544 [December 31, 2019 – $18,209] of insured mortgages and $207,757 [December 31, 2019 – $352,205] of uninsured mortgage and loan investments as at December 31, 2020. Of the uninsured mortgages, approximately $34,738 [December 31, 2019 – $35,014] 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 are currently recorded at fair value of $9,655 as at December 31, 2020 and had a total original principal balance of $38,423 [December 31, 2019 – three mortgages, original principal balance of $38,825, and fair value of $13,133].

The maturity profile of the principal amount of the loans in the table below is based on the earlier of contractual renewal or maturity dates:

						2020	2019
	2021	2022	2023	2024	2025 and thereafter	Total	Total
Residential	**57,456**	**4,012**	**578**	**11,082**	**2,152**	**75,280**	71,591
Commercial	**160,529**	**5,021**	**666**	**365**	**209**	**166,790**	298,823
	$217,985	**$9,033**	**$1,244**	**$11,447**	**$2,361**	**$242,070**	$370,414

Interest income earned for the year was $14,337 [2019 – $15,065] 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:

	2020	2019
Property, plant and equipment, net	**10,483**	11,029
Right-of-use assets	**22,725**	7,263
Goodwill	**29,776**	29,776
	$62,984	$48,068

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 one to seven years. The related lease liability of $22,922 as at December 31, 2020, 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 Company'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, 2020, the Company managed mortgages under administration of $118,723,990 [2019 – $111,378,891], 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, 2020, the Company administered 342,871 mortgages [2019 – 310,415] for 105 institutional investors [2019 – 108] with an average remaining term to maturity of 42 months [2019 – 40 months].

Mortgages under administration are serviced as follows:

	2020	2019
Institutional investors	**80,725,722**	76,040,779
Mortgages accumulated for sale or securitization and mortgage and loan investments	**2,495,926**	2,306,608
Mortgages pledged under securitization	**33,827,022**	31,776,442
CMBS conduits	**1,675,320**	1,255,062
	$118,723,990	$111,378,891

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.

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, 2020 was $852,361 [2019 – $690,394]. As at December 31, 2020, the Company has included in accounts receivable and sundry $374 [2019 – $156] of uninsured non-performing mortgages.

9. BANK INDEBTEDNESS

Bank indebtedness includes a revolving credit facility of $1,250,000 [2019 – $1,250,000] maturing in March 2024. At December 31, 2020, $682,832 [2019 – $797,758] 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, 2020, debt related to securitized mortgages was $34,265,504 [2019 – $32,245,793], net of unamortized discounts of $74,425 [2019 – $100,967]. 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, 2020 and 2019:

2020

	Less than 3 years	3 to 5 years	6 to 10 years	Total notional amount	Fair value
Interest rate swap contracts	**$2,634,822**	**$ 1,102,126**	**$44,983**	**$3,781,931**	**$(35,163)**

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

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 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 invested in FNFLP.

On November 17, 2020, the Company issued $200 million Series 3 senior unsecured notes for a five-year term pursuant to a private placement under an offering memorandum. The notes bear interest at 2.961% payable in equal semi-annual payments commenting May 17, 2021. On settlement, the net proceeds of the offering [$199.3 million, net of financing fees], were invested in FNFLP.

On April 9, 2020, the Company repaid its maturing $175 million Series 1 senior unsecured notes.

13. COMMITMENTS, GUARANTEES AND CONTINGENCIES

As at December 31, 2020, the Company has the following operating lease commitments for its office premises:

2021	7,931
2022	10,303
2023	9,848
2024 and thereafter	18,844
	$46,926

Outstanding commitments for future advances on mortgages with terms of one to 10 years amounted to $2,456,591 as at December 31, 2020 [2019 – $1,446,303]. 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, 2021.

16. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

	2020	**2019**
Accrued liabilities	**70,514**	52,748
Accrued dividends payable	**11,153**	10,508
Accrued interest on securitization debt	**51,187**	58,225
Servicing liability	**29,996**	20,959
Lease liability	**22,922**	7,466
	$185,772	$149,906

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

[b] Capital Stock

Balance, December 31, 2020 and 2019

	#	$
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 at December 31, 2020, and December 31, 2019, 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

	2020	2019
Net income attributable to shareholders	**190,229**	177,213
Less: dividends declared on preferred shares	**(2,846)**	(3,057)
Net income attributable to common shareholders	**187,383**	174,156
Number of common shares outstanding	**59,967,429**	59,967,429
Basic earnings per common share	**$3.12**	$2.90

18. INCOME TAXES

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

	2020	2019
Related to origination and reversal of timing differences	(3,971)	3,769
Decrease in future tax rates	(429)	(169)
	$(4,400)	$3,600

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

	2020	2019
Income taxes relating to the current year	72,800	60,900
Income taxes related to the prior year	100	—
	$72,900	$60,900

The effective income tax rate reported in the consolidated statements of income varies from the Canadian tax rate of 26.47% for the year ended December 31, 2020 [2019 – 26.61%] for the following reasons:

	2020	2019
COMPANY'S STATUTORY TAX RATE	26.47%	26.61%
Income before income taxes	258,729	241,713
Income tax at statutory tax rate	68,486	64,320
Increase (decrease) resulting from		
Permanent differences	200	345
Changes in future tax rates	(429)	(169)
Prior year adjustment	100	—
Other	143	4
INCOME TAX EXPENSE	$68,500	$64,500

The movement in significant components of the Company's deferred income tax liabilities and assets for the years ended December 31, 2020 and 2019 are as follows:

	As at January 1, 2020	Recognized in income and OCI	As at December 31, 2020
DEFERRED INCOME TAX			
Deferred placement fees receivable	11,189	5,364	16,553
Deferred costs – securitization	72,749	(4,859)	67,890
Unrealized gains on interest rate swaps	13,354	(16,217)	(2,863)
Other	505	306	811
Right-of-use asset	1,933	4,082	6,015
Lease liability	(1,987)	(4,080)	(6,067)
Carrying values of mortgages pledged under securitization in excess of tax values	(581)	3,210	2,629
Cumulative eligible capital property	(3,958)	296	(3,662)
Servicing liability	(5,577)	(2,363)	(7,940)
Fair value adjustments not deducted for tax purposes	(5,327)	(939)	(6,266)
Total	$82,300	$(15,200)	67,100

The amount of deferred tax recovery recorded in income and OCI consists of a recovery of $4,400 recorded in net income and a recovery of $10,800 recorded in OCI related to unrealized losses on cash flow hedges.

	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.

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 2020 and 2019.

	Decrease in interest rate[1]		Increase in interest rate	
	2020	**2019**	**2020**	**2019**
100 BASIS POINT SHIFT				
Impact on net income	**$4,255**	$5,909	**$(4,255)**	$(5,909)
200 BASIS POINT SHIFT				
Impact on net income	**$15,995**	$12,069	**$(8,511)**	$(11,818)

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

Credit Risk

Credit risk is the risk of loss associated with a counterparty's inability or unwillingness to fulfill its payment obligations. The Company's credit risk is mainly lending related in the form of mortgage default. The Company uses stringent underwriting criteria and experienced adjudicators to mitigate this risk. The Company's approach to managing credit risk is based on the consistent application of a detailed set of credit policies and prudent arrears management. As at December 31, 2020, 93% [2019 – 94%] 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 13.1% [2019 – 8.7%] of the Company's total revenue.

Fair Value Measurement

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

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

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

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

Valuation Methods and Assumptions

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

[a] 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 which are not supported by observable market data.

[c] Securities Owned and Sold Short

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

[d] Servicing Liability

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

[e] Other Financial Assets and Financial Liabilities

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

Carrying Value and Fair Value of Selected Financial Instruments

The fair value of the financial assets and financial liabilities of the Company approximates its carrying value, except for mortgages pledged under securitization, which has a carrying value of $34,137,421 [2019 – $31,995,424] and a fair value of $36,212,226 [2019 – $32,831,505]; debt related to securitized mortgages, which has a carrying value of $34,265,504 [2019 – $32,245,793] and a fair value of $34,909,488 [2019 – $31,831,691]; and senior unsecured notes, which have a carrying value of $398,554 [2019 – $374,025] and a fair value of $412,786 [2019 – $375,916]. 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:

	2020			
	Level 1	**Level 2**	**Level 3**	**Total**
FINANCIAL ASSETS				
Mortgages accumulated for sale	**—**	**50,035**	**—**	**50,035**
Mortgage and loan investments	**—**	**—**	**213,301**	**213,301**
Interest rate swaps	**—**	**21,109**	**—**	**21,109**
Total financial assets	**—**	**$71,144**	**$213,301**	**$284,445**
FINANCIAL LIABILITIES				
Securities sold short	**—**	**1,888,049**	**—**	**1,888,049**
Total financial liabilities	**—**	**$1,888,049**	**—**	**$1,888,049**

	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

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, 2020 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 $3,076 [2019 – loss of $4,300]. 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 2020 and 2019, the Company did not have any transfers between levels.

The following table presents changes in the fair values, including realized losses of $112,015 [2019 – losses of $74,832] of the Company's financial assets and financial liabilities for the years ended December 31, 2020 and 2019, all of which have been classified as FVTPL:

	2020	2019
FVTPL mortgages	**(3,076)**	(4,300)
Securities sold short	**(75,689)**	(8,270)
Interest rate swaps	**11,410**	2,915
	$(67,355)	$(9,655)

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, 2020 and 2019. 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, 2020	Investments	Unrealized losses recorded in income	Payment and amortization	Fair value as at December 31, 2020
FINANCIAL ASSETS					
Mortgage and loan investments	**$370,414**	**$130,165**	**$(3,076)**	**$(284,202)**	**$213,301**

	Fair value as at January 1, 2019	Investments	Unrealized losses 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

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, 2020, the ratio was 1.77:1 [2019 – 1.91:1]. 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.

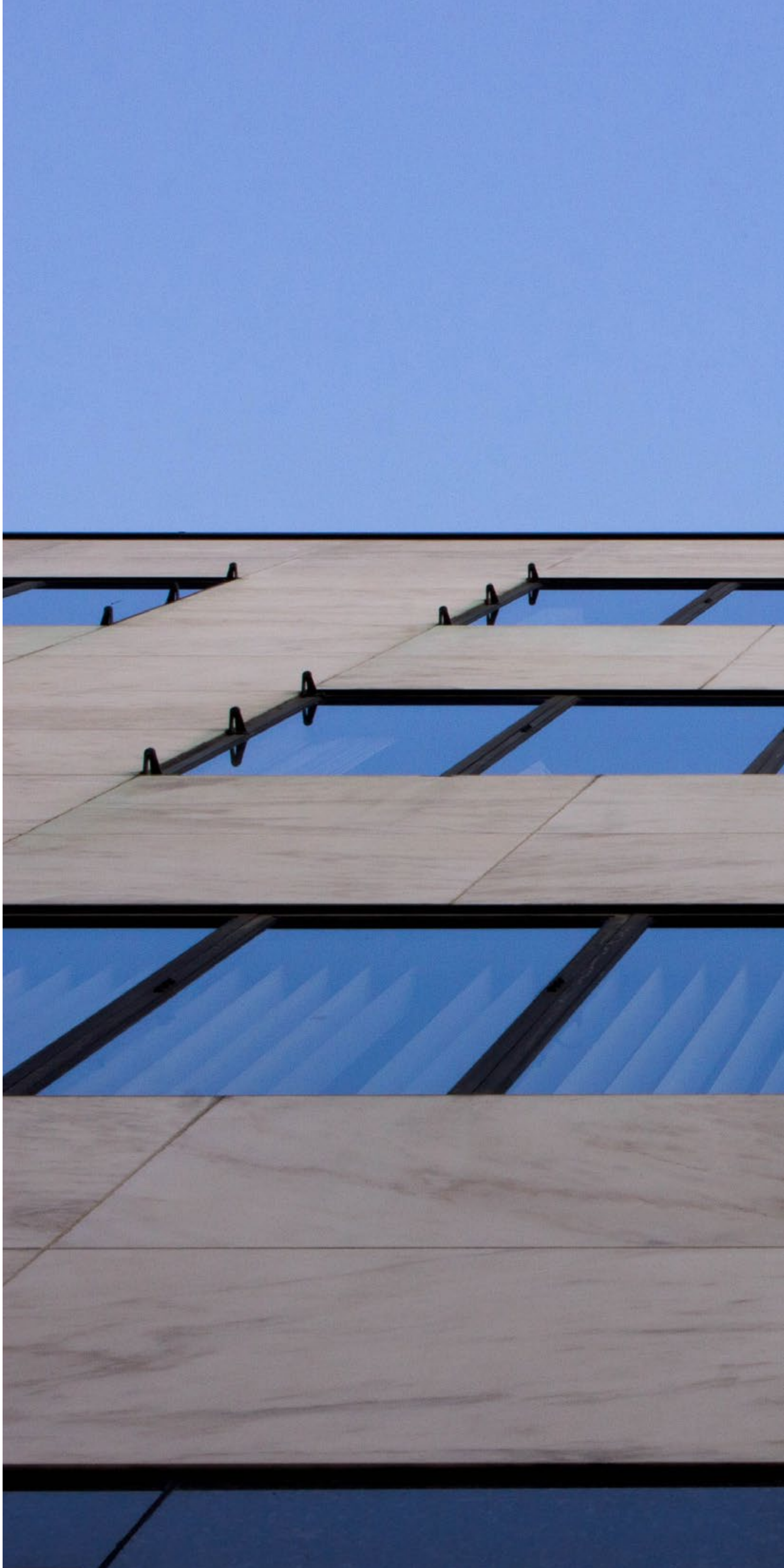
	2020		
	Residential	**Commercial**	**Total**
REVENUE			
Interest revenue – securitized mortgages	592,641	244,935	837,576
Interest expense – securitized mortgages	(507,187)	(200,975)	(708,162)
Net interest – securitized mortgages	85,454	43,960	129,414
Placement and servicing	400,506	140,534	541,040
Mortgage investment income *[note 6]*	47,111	21,922	69,033
Realized and unrealized losses on financial statements	(64,279)	(3,076)	(67,355)
	$468,792	**$203,340**	**$672,132**
EXPENSES			
Amortization	7,118	542	7,660
Interest	40,736	12,510	53,246
Other operating	279,853	72,644	352,497
	$327,707	**$85,696**	**$413,403**
INCOME BEFORE INCOME TAXES	**$141,085**	**$117,644**	**$258,729**
Identifiable assets	28,945,884	10,512,867	39,458,751
Goodwill	—	—	29,776
Total assets	**$28,945,884**	**$10,512,867**	**$39,488,527**
CAPITAL EXPENDITURES	**$2,510**	**$1,075**	**$3,585**

	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 losses on financial statements	(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

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 $48,671 of new mortgages for the related parties. The related parties also funded several progress draws totalling $21,677 on existing mortgages originated by the Company. All such mortgages, which are administered by the Company, have a balance of $179,320 as at December 31, 2020 [December 31, 2019 – $188,968]. As at December 31, 2020, 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 2020 was $3,212 [2019 – $3,016], net of third-party investor reimbursement.



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. 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 National 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 Guaranty Mortgage Insurance Company, which he owns in partnership with Ontario Teachers' Pension Plan. He is Chairman and co-owner of Duo Bank of Canada, formerly Walmart Canada Bank, whose subsidiary Fairstone Financial Inc. is Canada's largest non-bank consumer finance lender. Mr. Smith is the largest shareholder in Equitable Bank, Canada's Challenger Bank™ . He is also Chairman of Peloton Capital Management, a North American focused private equity firm. 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, which produces the Heritage Minutes and publishes The Canadian Encyclopedia. In 2019, Mr. Smith was inducted into the Canadian Business Hall of Fame.

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 M.Sc. 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. Prior thereto, from 1996 to 1998, Mr. Brough was Executive Vice President and Chief Financial Officer of iSTAR Internet, Inc. From 1994 to 2020, he was a Director and Chair of the Audit and Risk Committee of Kinross Gold Corporation. 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 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 Committee of Wheaton Precious Metals Corp.
Mr. Brough was formerly a director and Chairman of the Audit Committee of Canadian Real Estate Investment Trust from 2008 to 2018. He holds a Bachelor of Arts degree (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 was appointed Executive Chair and Chair of the Investment Committee of Dixon Mitchell Investment Canada Inc., a Vancouver-based investment management company, on January 1, 2021. From 2000 to 2020, he was President of Dixon Mitchell Investment Counsel Inc. Prior to that, he 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 6, 2021, 9:30 a.m. EDT
Virtually as provided
by Computershare Investor Services Inc.

https://web.lumiagm.com/291683989

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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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

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