



## **Bridgewater Bank Regulatory Disclosures September 30, 2013**

This document was prepared to fulfill regulatory requirements of the Office of the Superintendent of Financial Institutions Canada. Public disclosure requirements under Basel II Pillar 3, Basel III Pillar 3, OSFI Guideline B-20 and other OSFI guidance are provided. All figures unless stated otherwise are in thousands of dollars.

The information contained in this document has not been audited.

## Corporate Profile

Bridgewater Bank (the bank), a federally regulated institution, is supervised by the Office of the Superintendent of Financial Institutions Canada (OSFI). The bank is owned by the Alberta Motor Association and BwB Financial Holdings Ltd. The Alberta Motor Association is the majority shareholder.

The bank specializes in residential mortgages and deposit products through a select network of brokers. In addition, it is the exclusive issuer of the CAA MasterCard. The bank serves customers across Canada, with the exception of Quebec. It does not offer Home Equity Lines of Credit (HELOC) loans nor does it operate or offer products or services in foreign jurisdictions.

## Capital Shares

### **Class A shares**

Class A shares have no voting rights and are non-redeemable at the option of the bank or non-retractable at the option of the holder. Class A shares are convertible into common shares if OSFI deems common shares are needed to restore the bank's viability or if the Canadian government injects capital into the bank because it is deemed non-viable without the capital injection. Class A shares are considered Additional Tier 1 non-viability contingent capital (NVCC) for OSFI requirements.

### **Common shares**

Common shares have voting rights. They are considered Common Equity Tier 1 capital for OSFI requirements.

### **Subordinated debt**

The bank has issued subordinated notes which are unsecured and subordinated to all other indebtedness of the bank. The loans bear interest at 10% and mature July 2023. The subordinated debt automatically converts into common shares if OSFI deems common shares are needed to restore the bank's viability or if the Canadian government injects capital into the bank because it is deemed non-viable without the capital injection. The subordinated debt is considered Tier 2 NVCC capital for OSFI requirements.

## Capital Management

The bank manages its capital under guidelines established by OSFI. The regulatory capital guidelines measure capital in relation to credit, market and operational risks. The bank qualifies to use the standardized approach for the measurement of credit risk and the basic indicator approach for the measurement of operational risk.

The bank has three main objectives. They are 1) to ensure there is sufficient capital in order to meet regulatory restrictions on its assets-to-capital multiple; 2) to allow for asset accumulation to manage cash flow commitments under normal operating environments; and 3) to develop and introduce new products and expand current offerings. The bank has various capital policies, procedures and controls which it utilizes to achieve these objectives.

The bank is fully applying the Basel III deductions to calculate the all-in target ratios as per OSFI's Capital Adequacy Guidelines. The following details the bank's capital position under Basel III capital requirements as of September 30, 2013:

<b>Modified Capital Disclosure Template</b>		<b>All-in</b>	<b>Transitional</b>
<b>Common Equity Tier 1 capital: instruments and reserves</b>			
1	Directly issued qualifying common share capital (and equivalent for non-joint stock companies) plus related stock surplus	43,000	
2	Retained earnings	(13,500)	
6	<b>Common Equity Tier 1 capital before regulatory</b>	<b>29,500</b>	
<b>Common Equity Tier 1 capital: regulatory adjustments</b>			
28	Total regulatory adjustments to Common Equity Tier 1	(10,011)	
29	<b>Common Equity Tier 1 capital (CET1)</b>	<b>19,489</b>	<b>29,500</b>
<b>Additional Tier 1 capital: instruments</b>			
30	Directly issued qualifying Additional Tier 1 instruments plus related stock surplus	40,000	
36	<b>Additional Tier 1 capital before regulatory adjustments</b>	<b>40,000</b>	
<b>Additional Tier 1 capital: regulatory adjustments</b>			
43	<b>Total regulatory adjustments to Additional Tier 1</b>	-	
44	<b>Additional Tier 1 capital (AT1)</b>	<b>40,000</b>	
45	<b>Tier 1 capital (T1 = CET1 + AT1)</b>	<b>59,489</b>	<b>69,500</b>
<b>Tier 2 capital: instruments and provisions</b>			
46	Directly issued qualifying Tier 2 instruments plus related stock surplus	25,500	
51	<b>Tier 2 capital before regulatory adjustments</b>	<b>25,500</b>	
<b>Tier 2 capital: regulatory adjustments</b>			
57	<b>Total regulatory adjustments to Tier 2 capital</b>	-	
58	<b>Tier 2 capital (T2)</b>	<b>25,500</b>	
59	<b>Total capital (TC = T1 + T2)</b>	<b>84,989</b>	<b>95,000</b>
60	<b>Total risk-weighted assets</b>	<b>229,553</b>	<b>239,564</b>
<b>Capital ratios</b>			
61	Common Equity Tier 1 (as a percentage of risk-weighted assets)	8.49%	12.31%
62	Tier 1 (as a percentage of risk-weighted assets)	25.92%	29.01%
63	Total capital (as a percentage of risk-weighted assets)	37.02%	39.66%
<b>OSFI all-in target</b>			
69	Common Equity Tier 1 capital all-in target ratio	7.00%	
70	Tier 1 capital all-in target ratio	0.00%	
71	Total capital all-in target ratio	0.00%	

## Risk-Weighted Assets

The following table provides a breakdown of credit risk exposures as of September 30, 2013. Average exposure is calculated by taking the average of the quarterly gross exposures for a 12 month period.

	Gross exposure	Average exposure	RWA	Capital Required
Bank	\$ 186,739	\$ 238,208	\$ 37,348	\$ 2,614
Retail residential mortgages	2,153,286	2,333,323	52,282	3,660
Other retail	52,547	46,664	37,888	2,652
Other assets	34,747	38,127	34,747	2,432
Total Credit Risk	2,427,319	2,656,322	162,265	11,359
Operational Risk	-	-	67,288	4,710
Total Risk-Weighted Assets	\$2,427,319	\$2,656,322	\$ 229,553	\$ 16,069

## Risk Management

### Credit Risk

Credit risk is the risk of loss resulting from the failure of a counterparty to honour its financial obligation. The bank is exposed to credit risk through cash, restricted cash, amounts receivable, restricted investments, loans and derivative financial assets.

Credit risk management over day-to-day operations is provided by the Credit Management Committee. All business and credit risks are reported on the enterprise risk management monitor, which is governed by the Enterprise Risk Management Committee. The Assets and Liabilities Committee (ALCO) also provides financial oversight over credit risk. Credit risk management is a component of the Risk Management Framework, approved by the Audit Committee and ALCO. ALCO ensures the bank meets mortgage insurers' compliance standards and reviews arrears and underwriting post-assessment reporting. This is also communicated to the Audit Committee.

The bank manages credit risk with respect to cash and restricted cash by holding currency with major Canadian banks. Restricted investments are invested in treasury bills, federal bonds and securities guaranteed by the Government of Canada. Mortgages, both securitized and non-securitized, are insured against credit losses, which reduce the bank's credit risk, except for a small portion of conventional uninsured mortgages in the total portfolio. Both types of mortgages are residential mortgages and all credit card loans are to individuals. Funded mortgages also comply with the product and underwriting policies of the bank and the mortgage insurers, and property is held as collateral to mitigate the risk of loss. The majority of credit card loans are unsecured but credit risk is managed through assigning credit limits to customers. The bank maintains provisions for potential credit losses.

The bank is also exposed to credit risk through contracts with third parties which provide mortgage insurance and derivatives to manage interest rate risk. This counterparty credit risk is mitigated by contracting with reputable organizations that have investment-grade credit ratings

and by utilizing a number of different organizations, where possible, to minimize the impact of the risk of any one counterparty defaulting on its contractual obligations.

In the event of an economic downturn, the bank is well-positioned to continue mortgage lending, provide security and mitigate increasing risk. Compliance with the Canadian regulatory system ensures that extremely high risk mortgages, such as sub-prime mortgages, are not made available and mortgages that pose a higher risk where the down payment is less than 20% of the mortgage loan are insured against losses. The bank's mortgage default rate for 2012 was low and it anticipates the mortgage delinquency rate will remain stable at around 3%. As of September 30, 2013, 93.70% of issued mortgages are insured, which reduces the bank's risk of financial loss. The bank continues to have strong relationships with Canada's principle insurers, CMHC and Genworth Financial.

**a) Impaired and past due loans**

The bank maintains a provision for credit losses which, in management's opinion, is adequate to absorb all losses related to loans that have occurred as a result of one or more loss events, whether detected or not, including accrued interest. The provision for credit losses consists of specific provisions and a collective provision and the methodology and assumptions used for estimating each are reviewed on a regular basis.

There is objective evidence of impairment when one of the following conditions is met:

- the interest or principal repayment is contractually 90 days or more past due, unless the loan is fully secured or in the process of collection, or
- there is reason to believe that a portion of the principal or interest cannot be collected, such as financial difficulties of the borrower or national or local economic conditions that correlate with defaults on the assets in the portfolio.

Specific mortgage provisions are determined on an item-by-item basis when an impaired loan is determined to be individually significant. The specific provision represents the amount required to reduce the carrying value of an impaired loan to its estimated realizable amount, taking into consideration, if applicable, proceeds available from mortgage insurers and collateral held.

The following provides aging information for loans that are past due as of September 30, 2013:

	Securitized mortgages	Residential mortgages	Credit card loans	Total
1-29 days	\$ 17,659	\$ 4,044	\$ 2,052	\$ 23,755
30-59 days	7,009	3,039	413	10,461
60-89 days	5,110	2,704	224	8,038
Over 90 days	14,504	13,776	506	28,786
	<u>\$ 44,282</u>	<u>\$ 23,563</u>	<u>\$ 3,195</u>	<u>\$ 71,040</u>

The following details the collective and specific provision for credit losses as of September 30, 2013:

	Collective	Specific	Total
At December 31, 2012	\$ 3,535	\$ 207	\$ 3,742
Provision	3,686	425	4,111
Write-offs	(2,587)	(30)	(2,617)
At September 30, 2013	<u>\$ 4,634</u>	<u>\$ 602</u>	<u>\$ 5,236</u>

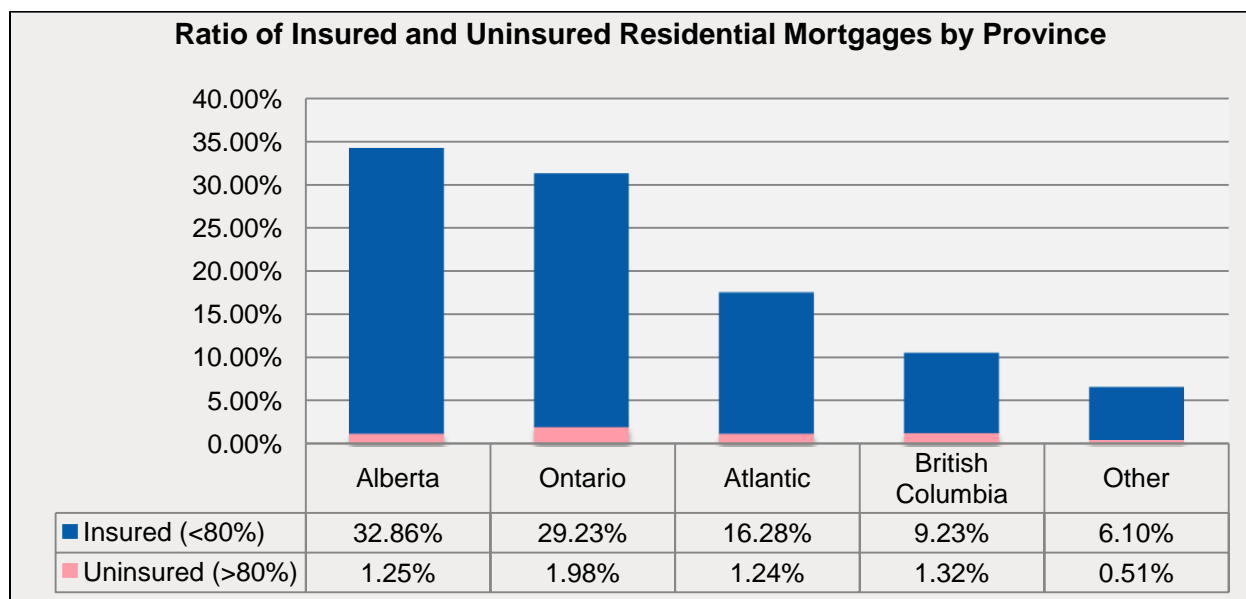
## b) Geographic breakdown

The following table provides a breakdown of loan balances as of September 30, 2013:

	Securitized mortgages	Residential mortgages	Credit card loans	Total	% of portfolio
Alberta	\$ 596,669	\$ 135,941	\$ 17,160	\$ 749,770	34.08%
Ontario	546,374	123,780	20,887	691,041	31.40%
Atlantic provinces	298,784	77,545	1,464	377,793	17.17%
British Columbia	174,705	51,846	7,923	234,474	10.66%
Other	105,649	36,411	5,062	147,122	6.69%
	<b>\$1,722,181</b>	<b>\$ 425,523</b>	<b>\$ 52,496</b>	<b>\$2,200,200</b>	<b>100.00%</b>
As a % of portfolio	<b>78.27%</b>	<b>19.34%</b>	<b>2.39%</b>	<b>100.00%</b>	

## c) Insured and uninsured portfolio

The bank's total mortgage portfolio is represented by 93.70% or \$2.0 billion in insured mortgages and 6.30% or \$135.1 million in uninsured mortgages. Insured or high-ratio mortgages are mortgages with less than 20% down payment on the lesser value of either the purchase price of a home or the appraised value. Below that threshold the Bank Act requires that mortgage default insurance must be obtained for a fee by a mortgage loan insurance provider. Uninsured or conventional mortgages are mortgage loans that do not exceed 80% of the lesser value of either the purchase price of a home or the appraised value. The following chart provides a breakdown of the mortgage portfolio by province by insured and uninsured as of September 30, 2013:



**d) Uninsured loan origination**

The average loan-to-value (LTV) of uninsured mortgages originated during the quarter ended September 30, 2013 was 69.92%. The following chart provides a breakdown on the average LTV by province of loans originated in the quarter ended September 30, 2013:

Province	Uninsured
Alberta	70.56%
Ontario	73.34%
Atlantic	69.98%
British Columbia	65.38%
Other	62.71%

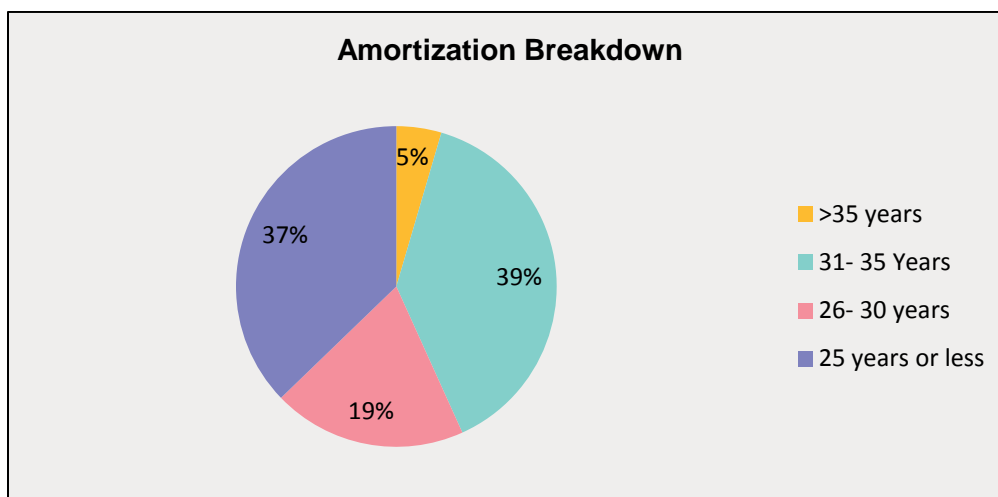
**e) Loan maturities**

The following table provides a breakdown of loan maturities as of September 30, 2013:

	Within 1 year	Over 1 to 3 years	Over 3 to 5 years	Over 5 years	Carrying value
Securitized mortgages receivable	\$ 691,135	\$ 769,556	\$ 261,490	\$ -	\$1,722,181
Mortgages	171,028	105,365	148,609	521	425,523
Credit card loans	52,496	-	-	-	52,496
Loans receivable	\$ 914,659	\$ 874,921	\$ 410,099	\$ 521	\$2,200,200

**f) Loan amortization**

The following chart provides a breakdown of mortgages outstanding based on original amortization as of September 30, 2013:



## Interest Rate Risk

Interest rate risk is the risk of loss from future changes in the prevailing level of interest rates. The bank is exposed to interest rate risk as a result of a difference, or gap, between the maturity or repricing date of interest rate-sensitive assets and liabilities, as well as on unsold mortgage commitments. The bank uses economic hedges to manage this risk, including synthetic bond shorts and interest rate swaps. It also uses two interest rate risk sensitivity models to measure the impact of changing interest rates on its equity position and net interest income for the 12 months following the measurement date. The objective is to measure the interest rate risk within guidelines.

Management incorporates expectations of future events where the maturity or repricing dates differ from contractual dates. Some contractual obligations, such as mortgages will be terminated prior to their maturity date through prepayments. The bank incorporates these assumptions in the management of interest rate risk exposure.

The bank's risk management framework includes interest rate risk management policies that are approved by the board and ALCO. ALCO establishes and recommends to the board interest rate risk tolerances, which the board approves. ALCO oversees stress testing of interest rate risk and the monitoring of risk mitigation strategies. The treasury department is responsible for managing the bank's interest rate risk positions in accordance with approved policies. It also assesses the impact of market events on the bank's net interest income and equity at risk on an ongoing basis.

Based on the bank's interest rate positions at September 30, 2013, an immediate and sustained change in interest rates would impact equity over the next 12 months, as follows:

Increase of 100 basis points	\$	(317)
Decrease of 100 basis points	\$	(1,136)

The following table summarizes the synthetic bond shorts, the interest rate swap portfolio and the related credit risk at September 30, 2013. Notional amounts represent the amount to which a rate or price is applied in order to calculate the exchange of cash flows. Current replacement cost represents the cost of replacing all positive fair value contracts using current market rates. The credit risk equivalent represents the current replacement cost and the potential future credit exposure if the counterparty defaults. Potential future credit exposure is determined based on a formula prescribed by OSFI.

	Notional amount	Current replacement cost	Credit risk equivalent
Interest rate contracts			
Within 1 year	\$ 278,088	\$ 529	\$ 529
Over 1 to 5 years	956,983	16,690	21,475
	<u>\$ 1,235,071</u>	<u>\$ 17,219</u>	<u>\$ 22,004</u>

The risk-weighted balance for these derivative instruments, which represents the credit risk equivalent weighted according to the credit worthiness of the counterparty as prescribed by OSFI, is \$5.



Cash deposits and restricted investments of \$10,658 are maintained with the counterparties as collateral based on the amount and position of securities outstanding. These amounts are restricted and not available for general use. The counterparties to the various derivatives can request additional collateral if the bank increases its positions or if unrealized losses exceed agreed upon limits.

### **Liquidity Risk**

Liquidity risk is the risk that cash demands or funding obligations cannot be met as they come due. Liquidity risk also includes the risk of not being able to liquidate assets in a timely manner at a reasonable price. The bank is exposed to liquidity risk due to the mismatching of the duration of assets, particularly the maturity of mortgages, the repayment of credit card receivables and liabilities, particularly term deposits. The bank is also exposed to liquidity risk to the extent that the bank's unfunded mortgage and credit card commitments, repurchase commitments outstanding and trade obligations committed but not yet paid exceed available cash or ability to raise deposits.

The bank's risk management framework includes liquidity and funding policies approved by the board and ALCO. ALCO establishes and recommends to the board liquidity risk tolerances, which the board approves. It also reviews the composition and terms of assets and liabilities, reviews liquidity and funding policies and regularly monitors compliance with these policies. ALCO also oversees stress testing of liquidity and funding risk and the monitoring of the bank's contingency funding plan. The treasury department is responsible for managing the bank's liquidity and funding positions in accordance with approved policies and assesses the impact of market events on liquidity requirements on an ongoing basis.

The bank evaluates total liquid assets against funding requirements and stress test scenarios to ensure liquid assets are available to cover current needs and during periods of market stress. Prescribed standard stress tests and stress tests dependent upon the risks existing at the time of testing are performed monthly. The results are reported to ALCO and the board. The bank's policies address the minimum level of liquid assets, the composition of liquid assets, the stress tests to be completed, and the frequency of assessments. The bank's liquid assets are made up of cash with large institutions, and unencumbered, high credit quality assets. The bank's liquidity coverage ratio is 1.31, which is within board policy limits.

Liquidity is managed by selling or securitizing funded mortgages to investors and via the management of the amount and term of outstanding deposits. The bank monitors its exposure to funding sources and sets limits to reduce the bank's reliance on any one funding source. Investors include whole loan investors, mortgage-backed securities (MBS) investors and the Canadian Housing Trust (CHT) through the Canada Mortgage Bond program. As the bank is not rated by a recognized credit agency, a rated intermediary is required to act on its behalf in dealings with the CHT. The bank continues to maintain liquidity through issuing MBS, selling to whole loan investors, and raising deposits through deposit brokers. Although the bank has deposits maturing within one year, liquidity is expected to be maintained through continued mortgage sales or securitizations, renewal of a portion of these deposits and raising new deposits.

The treasury department prepares weekly three-month cash requirements forecasts (including lending commitments, mortgage sales and securitizations and deposits issuances and maturities) that are updated and monitored daily with regular review by ALCO. As well, capital requirements are managed and monitored to ensure compliance with regulatory tests.

## Remuneration

Key management personnel include executive management and board directors as these groups have the authority and responsibility for planning, directing and controlling the activities of the bank. The bank's compensation costs are:

	Year ended 12/31/2012	Projected 12/31/2013
Salaries	\$ 962	\$ 1,046
Short-term employee benefits	18	19
Post-employment benefits	143	186
	<u>\$ 1,123</u>	<u>\$ 1,251</u>

Variable compensation is negligible and is not based on performance objectives. Variable compensation to executive management is equivalent to the variable compensation offered to all staff. Board directors receive no other compensation apart from board of director fees.