Consolidated Financial Statements of

VERSABANK

Years ended October 31, 2018 and 2017

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of VersaBank

We have audited the accompanying consolidated financial statements of VersaBank, which comprise the consolidated balance sheets as at October 31, 2018 and October 31, 2017, the consolidated statements of comprehensive income, changes in shareholders' equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of VersaBank as at October 31, 2018 and October 31, 2017, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

KPMG LLP

Chartered Professional Accountants, Licensed Public Accountants

November 27, 2018

London, Canada

VERSABANK

Consolidated Balance Sheets
As at October 31, 2018 and 2017

(thousands of Canadian dollars)

	2018	2017
Assets		
Cash and cash equivalents (note 5)	$ 129,781	$ 159,909
Securities (note 6)	10,017	262
Loans, net of allowance for credit losses (note 7)	1,631,026	1,520,857
Other assets (note 8)	38,306	44,021
	$ 1,809,130	$ 1,725,049
Liabilities and Shareholders' Equity		
Deposits (note 10)	$ 1,437,431	$ 1,376,006
Subordinated notes payable (note 11)	9,844	9,786
Securitization liabilities (note 12)	33,310	33,256
Other liabilities (note 13)	104,978	97,460
	1,585,563	1,516,508
Shareholders' equity:		
Share capital (note 14)	182,094	182,094
Retained earnings	41,473	26,443
Accumulated other comprehensive income	-	4
	223,567	208,541
	$ 1,809,130	$ 1,725,049

The accompanying notes are an integral part of these Consolidated Financial Statements.

On behalf of the Board:

D.R. Taylor

David R. Taylor
President and Chief Executive Officer

Hon. Thomas A. Hockin
Chairman of the Board

VERSABANK

Consolidated Statements of Comprehensive Income
Years ended October 31, 2018 and 2017

(thousands of Canadian dollars, except per share amounts)

	2018	2017
Interest income:		
Loans	$ 78,509	$ 70,424
Cash and securities	2,405	1,341
	80,914	71,765
Interest expense:		
Deposits and other	28,557	26,473
Subordinated notes	858	1,309
	29,415	27,782
Net interest income	51,499	43,983
Non-interest income (loss)	186	(141)
Total revenue	51,685	43,842
Provision for (recovery of) credit losses (note 7(b))	334	(125)
	51,351	43,967
Non-interest expenses:		
Salaries and benefits	14,337	13,656
General and administrative	9,697	11,399
Premises and equipment	2,304	2,135
	26,338	27,190
Restructuring charges (note 16)	-	2,045
	26,338	29,235
Income before income taxes	25,013	14,732
Income taxes (recovery) (note 17)	6,939	(4,740)
Net income	$ 18,074	$ 19,472
Other comprehensive income (loss), net of tax		
Net unrealized gains (losses) on assets held as available-for-sale (1)	(4)	(2)
Comprehensive income	$ 18,070	$ 19,470
Basic and diluted income per common share (note 18)	$ 0.75	$ 0.83
Weighted average number of common shares outstanding	21,123,559	20,864,322

(1) Net of income tax benefit of $1 (2017 - $1).

The accompanying notes are an integral part of these Consolidated Financial Statements.

VERSABANK

Consolidated Statements of Changes in Shareholders' Equity
Years ended October 31, 2018 and 2017

(thousands of Canadian dollars)

	2018	2017
Common shares (note 14):		
Balance, beginning of year	$ 152,612	$ 147,224
Impact of amalgamation of PWC Capital Inc. (note 26)	–	5,388
Balance, end of year	$ 152,612	$ 152,612
Preferred shares (note 14):		
Series 1 preferred shares		
Balance, beginning and end of year	$ 13,647	$ 13,647
Series 3 preferred shares		
Balance, beginning and end of year	$ 15,690	$ 15,690
Contributed surplus (note 14):		
Balance, beginning and end of year	$ 145	$ 145
Total share capital	$ 182,094	$ 182,094
Retained earnings:		
Balance, beginning of year	$ 26,443	$ 9,172
Net income	18,074	19,472
Dividends paid on common and preferred shares	(3,044)	(2,201)
Balance, end of year	$ 41,473	$ 26,443
Accumulated other comprehensive income, net of taxes:		
Balance, beginning of year	$ 4	$ 6
Other comprehensive loss	(4)	(2)
Balance, end of year	$ –	$ 4
Total shareholders' equity	$ 223,567	$ 208,541

The accompanying notes are an integral part of these Consolidated Financial Statements.

VERSABANK

Consolidated Statements of Cash Flows
Years ended October 31, 2018 and 2017

(thousands of Canadian dollars)

	2018	2017
Cash provided by (used in):		
Operations:		
Net income	$ 18,074	$ 19,472
Adjustments to determine net cash flows:		
Items not involving cash (note 19)	(43,603)	(48,295)
Interest received	77,260	70,541
Interest paid	(27,681)	(29,192)
Change in operating assets and liabilities:		
Loans	(106,795)	44,096
Deposits	59,804	7,925
Change in other assets and liabilities	8,037	13,333
	(14,904)	77,880
Investing:		
Purchase of securities	(10,017)	–
Proceeds from sale and maturity of securities	255	9,593
Purchase of property, plant and equipment	(993)	(2,243)
Cash acquired on amalgamation (note 26)	–	1,569
Transaction costs associated with amalgamation (note 26)	–	(1,852)
	(10,755)	7,067
Financing:		
Repayment of subordinated notes	–	(4,500)
Redemption of securitization liability	–	(10,307)
Dividends paid	(3,044)	(2,201)
Income taxes paid	(1,425)	(1,994)
	(4,469)	(19,002)
Increase (decrease) in cash and cash equivalents	(30,128)	65,945
Cash and cash equivalents, beginning of year	159,909	93,964
Cash and cash equivalents, end of year (note 5)	$ 129,781	$ 159,909

The accompanying notes are an integral part of these Consolidated Financial Statements.

1. Reporting entity:

VersaBank (the "Bank") operates as a Schedule 1 bank under the *Bank Act (Canada)* and is regulated by the Office of the Superintendent of Financial Institutions ("OSFI"). The Bank, whose shares trade on the Toronto Stock Exchange, provides commercial lending services to selected niche markets in Canada.

The Bank is incorporated and domiciled in Canada, and maintains its registered office at Suite 2002, 140 Fullarton Street, London, Ontario, Canada, N6A 5P2. On January 31, 2017, the Bank and PWC Capital Inc. ("PWC"), whose shares also traded on the Toronto Stock Exchange, amalgamated pursuant to section 228 of the *Bank Act* (*Canada*) with the amalgamated entity continuing under the name VersaBank (note 26).

2. Basis of preparation:

These Consolidated Financial Statements have been prepared in accordance with the *Bank Act (Canada).* The Superintendent of Financial Institutions Canada (the "Superintendent" or "OSFI"), has instructed that the financial statements are to be prepared in accordance with International Financial Reporting Standards ("IFRS"). The significant accounting policies used in the preparation of these consolidated financial statements, including the accounting requirements of the Superintendent, are summarized below. These accounting policies conform, in all material respects, to IFRS.

a) Statement of compliance:

These Consolidated Financial Statements have been prepared in accordance with IFRS as issued by the International Accounting Standards Board ("IASB").

b) Date authorized for issuance:

These Consolidated Financial Statements were approved and authorized for issue by the Board of Directors of the Bank on November 27, 2018.

c) Basis of measurement:

These Consolidated Financial Statements have been prepared on the historical cost basis except for securities designated as available-for-sale which are measured at fair value in the Consolidated Balance Sheets.

d) Functional and presentation currency:

These Consolidated Financial Statements are presented in Canadian dollars which is the Bank's functional currency.

2. Basis of preparation – continued:

e) Use of estimates and judgments:

In preparing these Consolidated Financial Statements, management has exercised judgment and developed estimates in applying accounting policies and generating reported amounts of assets and liabilities at the date of the financial statements and income and expenses during the reporting periods. Areas where significant judgment was applied were in the assessment of impairment of loans. Estimates were developed in the calculation of the allowance for credit losses and the measurement of deferred income taxes.

It is reasonably possible, on the basis of existing knowledge, that actual results may vary from that expected in the generation of these estimates. This could result in material adjustments to the carrying amounts of assets and/or liabilities affected in the future.

Estimates and their underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are applied prospectively once they are recognized.

3. Significant accounting policies:

The significant accounting policies used in the preparation of these Consolidated Financial Statements were applied consistently to all years presented and are summarized below:

a) Principles of consolidation:

The Bank holds 100% of the common shares of VersaVault Inc., VersaJet Inc., PW Capital Inc., AMSDMS Software Inc., and Pacific & Western Public Sector Financing Corp. The Consolidated Financial Statements include the accounts of these subsidiaries.

All significant intercompany accounts and transactions have been eliminated.

b) Revenue recognition:

Interest income on securities and loans is recognized in net interest income using the effective interest rate method over the expected life of the instrument. Interest income earned but not yet collected on securities and loans is included in the respective securities and loans categories on the Consolidated Balance Sheets. Non-interest income from the previous credit card program was recognized over the expected term of the balance of the card and included in non-interest income.

Interest income from credit cards was calculated based on a pre-determined rate and was recognized as earned and included in net interest income.

3. Significant accounting policies – continued:

b) Revenue recognition – continued:

Interest income is recognized on impaired loans and is accrued using the rate of interest used to discount the future cash flows for purposes of measuring the impairment loss. Loan fees integral to the yield on the loan are amortized to interest income using the effective interest method; otherwise, the fees are recorded in non-interest income.

c) Financial instruments:

Upon initial recognition, all financial instruments are measured at fair value. Subsequent to initial recognition financial instruments are classified into various categories. The Bank groups all financial assets into one of the following classification categories: held-to-maturity, loans and receivables or available-for-sale. All financial liabilities are measured at amortized cost.

Financial assets that are classified as held-to-maturity, loans and receivables and financial liabilities are measured at amortized cost using the effective interest method. Available-for-sale financial assets are measured at fair value with unrealized gains and losses, net of tax, recognized in other comprehensive income.

Estimates of fair value are developed using a variety of valuation methods and assumptions. The Bank follows a fair value hierarchy to categorize the inputs used to measure fair value for its financial instruments. The fair value hierarchy is based on quoted prices in active markets (Level 1), models using inputs other than quoted prices but with observable market data (Level 2), or models using inputs that are not based on observable market data (Level 3).

Valuation models may require the use of inputs, transaction values derived from models and input assumptions sourced from pricing services. Valuation inputs are either observable or unobservable. The Bank looks to external readily observable market inputs when available and may include certain prices and rates for shorter-dated Canadian yield curves and bankers acceptances. Unobservable inputs may include credit spreads, probability of default and recovery rates.

3. Significant accounting policies – continued:

c) Financial instruments – continued:

The Bank has no significant Level 2 or Level 3 financial instruments.

i) Cash and cash equivalents:

Cash and cash equivalents are classified as held-to-maturity.

Cash includes deposits with Canadian chartered banks, net of cheques and other items in transit. Cash equivalents include government treasury bills with less than ninety days to maturity from the date of acquisition.

ii) Securities:

Securities are either classified as held-to-maturity or available-for-sale.

The Bank holds securities primarily for liquidity purposes and for investment purposes with the intention of holding the securities to maturity or until market conditions render alternative investments more attractive. Settlement date accounting is used for all securities transactions.

At the end of each reporting period, the Bank assesses whether or not there is any objective evidence to suggest that a security may be impaired. Objective evidence of impairment results from one or more events that occur after the initial recognition of the security which has an impact that can be reliably estimated on the estimated future cash flows of the security such as financial difficulty of the issuer. An impairment loss is recognized for an equity instrument if the decline in fair value is significant or prolonged, as such circumstances provide objective evidence of impairment.

Impairment losses on a held-to-maturity security are recognized in income in the period they are identified. When there is objective evidence of impairment of an available-for-sale security, the cumulative loss that has been recorded in Accumulated Other Comprehensive Income is reclassified to income. For available-for-sale debt securities, if in a subsequent period the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was first recognized, then the previously recognized impairment loss is adjusted through income to reflect the net recoverable amount of the impaired security. No adjustments of impairment losses are recognized for available-for-sale equity securities.

3. Significant accounting policies – continued:

c) Financial instruments – continued:

iii) Loans:

Loans are classified as loans and receivables and are initially measured at fair value plus incremental direct transaction costs. Loans are subsequently measured at amortized cost, net of allowance for credit losses, using the effective interest method.

The Bank assesses whether or not there is any objective evidence to suggest that the carrying value of the loans may be impaired. Impairment assessments are facilitated through the identification of loss events and assessments of their impact on the estimated future cash flows of the loans.

A loan is classified as impaired when, in management's opinion, there has been deterioration in credit quality to the extent that there is no longer reasonable assurance as to the timely collection of the full amount of principal and interest. Loans, except credit card receivables, where interest or principal is contractually past due 90 days are automatically recognized as impaired, unless management determines that the loan is fully secured, in the process of collection and the collection efforts are reasonably expected to result in either repayment of the loan or restoring it to current status. All loans, except credit card receivables, are classified as impaired when interest or principal is 180 days past due, except for loans guaranteed or insured by the Canadian government, provinces, territories, or a Canadian government agency, which are classified as impaired when interest or principal is contractually 365 days in arrears. Credit card receivables were written off when payments are 180 days past due, or upon receipt of a bankruptcy notification.

As loans are measured at amortized cost, an impairment loss is measured as the difference between the carrying amount and the present value of future cash flows discounted using the effective interest rate computed at initial recognition, if future cash flows can be reasonably estimated. When the amounts and timing of cash flows cannot be reasonably estimated, the carrying amount of the loan is reduced to its estimated net realizable value based on either:

i) the fair value of any security underlying the loan, net of expected costs of realization, or,

ii) observable market prices for the loan.

3. Significant accounting policies – continued:

c) Financial instruments – continued:

Impairment losses are recognized in income. If, in a subsequent period, the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was first recognized, then a recovery of a portion or all of the previously recognized impairment loss is adjusted through income to reflect the net recoverable amount of the impaired loan.

Real estate held for resale is recorded at the lower of cost and fair value, less costs to sell.

iv) Allowance for credit losses:

The Bank maintains an allowance for credit losses which, in management's opinion, is adequate to absorb all credit related losses in its loan portfolio. The allowance for credit losses consists of both individual and collective allowances and is reviewed on a monthly basis. The allowance is included in loans on the Consolidated Balance Sheets.

The Bank considers evidence of impairment for loans at both an individual asset and collective level. All individually significant loans are assessed for impairment first. All individually significant loans found not to be specifically impaired and all loans which are not individually significant are then collectively assessed for impairment.

The collective allowance is determined by separating loans into categories that are considered to have common risk elements and reviewing factors such as current portfolio credit quality trends, exposure at default, probability of default and loss given default rates and business and economic conditions. The collective allowance may also be adjusted by management using its judgment taking into account other observable and unobservable factors.

v) Transaction costs:

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or liability. Transaction costs related to held-to-maturity securities, loans and receivables, and available-for-sale financial assets, as well as financial liabilities are capitalized and amortized over the expected life of the instrument using the effective interest method. Transaction costs related to financial assets and liabilities at fair value through income are expensed in the Consolidated Statements of Income as incurred.

3. Significant accounting policies – continued:

c) Financial instruments – continued:

vi) Securitized mortgages and securitization liabilities:

In previous years, the Bank transferred pools of Government of Canada guaranteed residential mortgages to the Canada Housing Trust ("CHT"), a Canada Mortgage and Housing Corporation ("CMHC") sponsored entity.

When the derecognition criteria were not met, these transactions resulted in securitized mortgages being maintained on the Bank's Consolidated Balance Sheets and in the recognition of securitization liabilities when cash was received from counterparties to the transaction. Securitized mortgages are presented and accounted for as loans on the Consolidated Balance Sheets. Securitization liabilities are presented as a separate line item in the liabilities section on the Consolidated Balance Sheets.

Interest income earned on securitized mortgages and interest expense incurred on securitization liabilities are recognized using the effective interest method over the expected life of the underlying instrument.

vii) Embedded derivatives:

Certain derivatives embedded in other financial instruments are treated as separate derivatives when their economic characteristics and risk are not closely related to the host contract and the combined contract is not carried at fair value. Identified embedded derivatives are separated from the host contract and are recorded at fair value.

d) Property and equipment:

Property and equipment is carried at cost less accumulated amortization and impairment. Amortization on property and equipment is calculated primarily using the straight-line method over the useful life of the equipment which typically ranges between 5 and 20 years.

Property and equipment is subject to an impairment review if there are events or changes in circumstances which indicate that the carrying amounts may not be recoverable. Amortization expense and impairment write-downs are included in premises and equipment expense in the Consolidated Statements of Income.

e) Income taxes:

Current income taxes are calculated based on taxable income for the reporting period. Taxable income differs from accounting income because of differences in the inclusion and deductibility of certain components of income which are established by Canadian taxation authorities. Current income taxes are measured at the amount expected to be recovered or paid using statutory tax rates at the reporting period end.

3. Significant accounting policies – continued:

e) Income taxes – continued:

The Bank follows the asset and liability method of accounting for deferred income taxes. Deferred income tax assets and liabilities arise from temporary differences between financial statement carrying values and the respective tax base of those assets and liabilities. Deferred income tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years when temporary differences are expected to be recovered or settled.

Deferred income tax assets are recognized in the Consolidated Financial Statements to the extent that it is probable that the Bank will have sufficient taxable income to enable the benefit of the deferred income tax asset to be realized. Unrecognized deferred income tax assets are reassessed for recoverability at each reporting period end.

Current and deferred income taxes are recorded in income for the period, except to the extent that the tax arose from a transaction that is recorded either in Other Comprehensive Income or Equity, in which case the income tax on the transaction will also be recorded either in Other Comprehensive Income or Equity. Accordingly, current and deferred income taxes are presented in the Consolidated Financial Statements as a component of income, or as a component of Other Comprehensive Income.

f) Employee benefits:

i) Short-term benefits:

Short-term employee benefit obligations are recognized as employees render their services and are measured on an undiscounted basis.

A liability is recognized for the amount expected to be paid under a short-term cash bonus plan if the Bank has an obligation to make such payments as a result of past service provided by the employee and the obligation can be estimated reliably.

ii) Share-based payment transactions:

Equity-settled stock options

Employee stock options are measured using the Black-Scholes pricing model which is used to estimate the fair value of the options at the date of grant. Inputs to the Black-Scholes model include the closing share price on the grant date, the exercise price, the expected option life, the expected dividend yield, the expected volatility and the risk-free interest rate. Once the expected option life is determined, it is used in formulating the estimates of expected volatility and the risk-free rate. Expected future volatility is estimated using a historical volatility look-back period that is consistent with the expected life of the option.

3. Significant accounting policies – continued:

f) Employee benefits – continued:

The fair value of options which vest immediately are recognized in full as of the grant date, whereas the fair value of options which vest over time are recognized over the vesting period using the graded method which incorporates management's estimates of the options which are not expected to vest. The effect of a change in the estimated number of options expected to vest is a change in estimate and the cumulative effect of the change is recognized prospectively once the estimate is revised.

The fair value of stock options granted is recorded in salaries and benefits expense in the Consolidated Statements of Income and in Share Capital as a component of Contributed Surplus in the Consolidated Balance Sheets. When options are exercised, the consideration received and the estimated fair value previously recorded in Contributed Surplus is recorded as Share Capital.

The Bank's stock option plan is described in note 15.

g) Share capital:

The Bank's share capital consists of common shares, preferred shares and contributed surplus.

i) Share issuance costs:

Costs directly incurred with raising new share capital are charged against equity. Other costs are expensed as incurred.

ii) Contributed surplus:

Contributed surplus consists of the fair value of stock options granted since inception, less amounts reversed for exercised stock options. If granted options vest and then subsequently expire or are forfeited, no reversal of contributed surplus is recognized.

h) Segment reporting:

The Bank does not present segmented information in its Consolidated Financial Statements as it has determined that its operations fall into one segment, Banking, and further, that it operates in one geographic region, Canada.

4. Future changes in accounting policies:

There have been a number of standards and amendments that have been issued by the IASB that were not effective for the Bank's fiscal year end of October 31, 2018 and therefore have not been applied in preparing these consolidated financial statements. The following standards are expected to be applicable to the Bank:

Financial Instruments (IFRS 9)

In July, 2014, the IASB issued the final revised IFRS 9 standard which addresses classification, measurement and impairment of financial instruments and hedge accounting. IFRS 9 becomes effective for the Bank's fiscal year beginning on November 1, 2018.

IFRS 9 is required to be applied on a retrospective basis, with certain exceptions. As permitted, the Bank will not restate its prior period comparative consolidated financial statements upon adoption of the requirements of the new standard. Differences in the carrying amounts of financial instruments resulting from the adoption of IFRS 9 will be recognized in our opening November 1, 2018 retained earnings and accumulated other comprehensive income as if the Bank had always followed the new requirements. Based on October 31, 2018 data and current implementation status, the Bank estimates the adoption of IFRS 9 will not have a material impact on shareholders' equity or regulatory capital. The Bank continues to refine and monitor certain aspects of the impairment process which may change the actual impact on adoption.

Impairment

IFRS 9 introduces a new expected credit loss ("ECL") impairment model for all financial assets and certain off-balance sheet loan commitments and guarantees. The ECL model will result in an allowance for credit losses being recorded on financial assets regardless of whether or not there has been an actual loss event. This differs from the current approach under IAS 39 where the allowance recorded on performing loans is designed to capture only losses that have been incurred whether or not they have been specifically identified. The ECL model requires the recognition of credit losses based on 12 months of expected losses for performing loans and the recognition of lifetime expected losses on loans that have experienced a significant increase in credit risk since origination. The determination of a significant increase in credit risk is a function primarily of loan product type and the associated risk profile of same. The principal factors considered in making this determination include relative changes in the Bank's internal risk rating assignment, the loan's watchlist status, and the loan's delinquency status. Notwithstanding the above, the assessment of a significant increase in credit risk will require experienced credit judgement.

Impaired loans require recognition of lifetime losses and are expected to be similar to the individual allowance on impaired assets under IAS 39. IFRS 9 requires consideration of past events, current market conditions and reasonable and supportable information about future economic conditions, in determining whether there has been a significant increase in credit risk, and in estimating expected losses.

4. Future changes in accounting policies - continued:

Classification and Measurement

IFRS 9 requires lending assets to be classified based on the Bank's business model for managing the asset and the contractual cash flow characteristics associated with same. The business model test determines the classification based on the business purpose for holding the asset while the characterization of a debt instrument's cashflows is determined through a solely payment of principal and interest, ("SPPI") test. The SPPI test is conducted to identify whether or not the contractual cash flows of a debt financial instrument are consistent with a basic lending arrangement. Debt financial instruments that meet the SPPI test and are managed on a "hold to collect" basis will be classified as, and measured at amortized cost. Debt financial instruments that meet the SPPI test and are managed on a "hold to collect and for sale" basis will be classified as and measured at fair value through other comprehensive income ("FVOCI"). Debt financial instruments that are managed on a "held for trading" or "fair value" basis will be classified as and measured at fair value through profit or loss ("FVTPL"). Gains and losses recorded in other comprehensive income for debt instruments will be recognized in profit or loss on disposal.

Equity financial instruments will be measured at FVTPL unless an irrevocable designation is made to measure them at FVOCI. Gains or losses from changes in the fair value of equity instruments designated at FVOCI, including any related foreign exchange gains or losses, will be recognized in other comprehensive income.

The Bank has assessed its financial assets and determined that they meet the SPPI arrangement and will be classified as and measured at amortized cost with the exception of Securities, which will be measured at FVOCI.

Hedge Accounting

IFRS 9 introduces a new hedge accounting model that expands the scope of hedged items and risks eligible for hedge accounting and aligns hedge accounting more closely with risk management. The new model no longer specifies quantitative measures for effectiveness testing and does not permit hedge de-designation. IFRS 9 includes a policy choice that allows the Bank to continue to apply the existing hedge accounting rules. The Bank will not adopt the hedge accounting provisions of IFRS 9; however, as required by the standard, it will adopt the new hedge accounting disclosures as applicable. The Bank does not have any active hedging arrangements.

Leases (IFRS 16)

In January 2016, the IASB issued IFRS 16, requiring most leases to be recorded on the balance sheet. For lessees, most operating leases other than a short-term or low value leases will be capitalized, and will result in a balance sheet increase in lease assets and lease liabilities, and a decrease in operating lease expenses and increase in financing costs and amortization expense on the income statement. The new standard will not impact lessor accounting beyond additional disclosures. The new standard is effective for the Bank's fiscal year beginning November 1, 2019. The Bank is currently reviewing IFRS 16 to determine the impact of adoption on its consolidated financial statements.

5. Cash and cash equivalents:

(thousands of dollars)

	2018	2017
Deposits with regulated financial institutions	$ 129,781	$ 154,909
Treasury bills guaranteed by federal government	–	5,000
	$ 129,781	$ 159,909

6. Securities:

a) Portfolio analysis:

(thousands of dollars)

	2018	2017
Available-for-sale securities		
Securities issued or guaranteed by:		
Canadian federal government	$ 5,037	$ –
Canadian provincial governments	4,980	–
Canadian municipal governments	–	262
Total available-for-sale securities	$ 10,017	$ 262

b) Maturities and yields:

(thousands of dollars)

	2018	Yield	2017	Yield
Available-for-sale securities				
Within 3 months	$ –	–	$ 262	2.25%
3 months - 1 year	–	–	–	–
1 year - 2 years	10,017	2.01%	–	–
2 years - 5 years	–	–	–	–
Total available-for-sale securities	$ 10,017	2.01%	$ 262	2.25%

6. Securities – continued:

c) Unrealized gains and losses on securities:

(thousands of dollars)

	2018				2017			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Available-for-sale securities								
Securities issued or guaranteed by:								
Canadian federal	$ 5,037	$ –	$ –	$ 5,037	$ –	$ –	$ –	$ –
Canadian provinces	4,980	–	–	4,980	–	–	–	–
Canadian municipalities	–	–	–	–	257	5	–	262
Total available-for-sale securities	$ 10,017	$ –	$ –	$ 10,017	$ 257	$ 5	$ –	$ 262

There were no impairment charges during the years ended October 31, 2018 and October 31, 2017 related to the Bank's securities portfolio.

d) Fair value hierarchy:

Available-for-sale securities measured at fair value are classified into the fair value hierarchy as follows:

(thousands of dollars)

2018	Total	Level 1	Level 2	Level 3
Available-for-sale securities				
Securities issued or guaranteed by:				
Canadian federal government	$ 5,037	$ 5,037	$ –	$ –
Canadian provincial governments	4,980	4,980	–	–
Canadian municipal governments	–	–	–	–
Total available-for-sale securities	$ 10,017	$ 10,017	$ –	$ –

(thousands of dollars)

2017	Total	Level 1	Level 2	Level 3
Available-for-sale securities				
Securities issued or guaranteed by:				
Canadian federal government	$ –	$ –	$ –	$ –
Canadian provincial governments	–	–	–	–
Canadian municipal governments	262	–	262	–
Total available-for-sale securities	$ 262	$ –	$ 262	$ –

7. Loans:

a) Portfolio analysis:

(thousands of dollars)

	2018	2017
Government loans	$ 17,365	$ 22,574
Loan and lease receivables	889,822	806,347
Residential mortgages	93,528	81,190
Commercial mortgages	259,605	284,329
Construction mortgages	269,614	224,727
Commercial loans	94,450	95,293
Other	2,504	3,012
	1,626,888	1,517,472
Allowance for credit losses	(2,759)	(2,425)
Accrued interest	6,897	5,810
Total loans, net allowance for credit losses	$ 1,631,026	$ 1,520,857

The allowance for credit losses relates to the following loan portfolios:

(thousands of dollars)

	2018	2017
Government loans	$ 4	$ 5
Loan and lease receivables	399	361
Residential mortgages	318	314
Commercial mortgages	565	445
Construction mortgages	849	769
Commercial loans	607	522
Other	17	9
	$ 2,759	$ 2,425

The Bank holds security against the majority of its loans in the form of either mortgage interests over property, other registered securities over assets, guarantees and holdbacks on loan and lease receivables (note 13).

7. Loans – continued:

b) Allowance for credit losses:

The allowance for credit losses results from the following:

(thousands of dollars)

	Collective	Individual	2018 Total Allowance	2017 Total Allowance
Balance, beginning of year	$ 2,225	$ 200	$ 2,425	$ 3,031
Provision (recovery) for credit losses	134	200	334	(125)
Write-offs	-	-	-	(481)
Balance, end of year	$ 2,359	$ 400	$ 2,759	$ 2,425

c) Maturities and yields:

(thousands of dollars)

	Floating	Within 3 months	3 months to 1 year	1 year to 2 years	2 years to 5 years	Over 5 years	2018 Total	2017 Total
Total loans	$ 565,347	$ 25,522	$ 74,778	$ 126,858	$ 711,207	$ 123,176	$ 1,626,888	$ 1,517,472
Average effective yield	6.24%	5.91%	5.04%	4.30%	4.85%	4.49%	5.29%	4.69%

Average effective yields are based on book values and contractual interest rates, adjusted for the amortization of any deferred income and expenses.

d) Impaired loans:

At October 31, 2018, impaired loans were $627,000 (2017 - $627,000).

8. Other assets:

(thousands of dollars)

	2018	2017
Accounts receivable	$ 489	$ 504
Funds held for securitization liabilities (note 12)	6,078	5,227
Prepaid expenses and other	4,949	5,812
Property and equipment (note 9)	8,390	8,020
Deferred income tax asset (note 17)	18,400	24,458
	$ 38,306	$ 44,021

9. Property and equipment:

(thousands of dollars)

	2018	2017
Cost	$ 16,138	$ 15,145
Accumulated amortization	(7,748)	(7,125)
	$ 8,390	$ 8,020

None of the Bank's property and equipment is subject to title restrictions, nor is any pledged as security for the Bank's liabilities.

Total amortization expense recorded for property and equipment for the year ended October 31, 2018 totalled $623,000 (2017 - $553,000).

10. Deposits:

(thousands of dollars)

Maturity period	Demand/ Floating	Within 3 months	3 months to 1 year	1 year to 2 years	2 years to 5 years	Accrued Interest	2018 Total	2017 Total
Total deposits	$ 361,796	$ 194,449	$ 285,513	$ 296,939	$ 286,057	$ 12,677	$ 1,437,431	$ 1,376,006
Average effective interest rate	1.06%	1.84%	2.06%	2.17%	2.52%		1.87%	1.53%

Average effective interest rates are based on book values and contractual interest rates.

11. Subordinated notes payable:

(thousands of dollars)

	2018	2017
Ten year term, unsecured, callable, subordinated notes payable, principal amount of $10.0 million, effective interest rate of 8.77%, maturing 2021	$ 9,844	$ 9,786
	$ 9,844	$ 9,786

12. Securitization liabilities:

Securitization liabilities include amounts payable to counterparties for cash received upon initiation of securitization transactions, accrued interest on amounts payable to counterparties, and the unamortized balance of deferred costs and discounts that arose upon initiation of the securitization transactions. The amounts payable to counterparties bear interest at rates ranging from 3.55% - 3.95% and mature in 2020. Securitized insured mortgages and other assets with a carrying value of $33.1 million (2017 - $33.1 million) are pledged as collateral for these liabilities.

13. Other liabilities:

(thousands of dollars)

	2018	2017
Accounts payable and other	$ 3,474	$ 3,737
Cash collateral and amounts held in escrow	5,343	4,945
Holdbacks payable on loan and lease receivables	96,161	88,778
	$ 104,978	$ 97,460

14. Share capital:

a) Authorized:

Common shares:

The Bank is authorized to issue an unlimited number of voting common shares with no par value.

Series 1 Preferred shares:

The Bank is authorized to issue an unlimited number of Series 1 preferred shares with a par value of $10.00. These preferred shares are Basel III-compliant, non-cumulative five year rate reset preferred shares which includes non-viability contingent capital (“NVCC”) provisions which would require the preferred shares to be converted to common shares upon a trigger event (as defined by OSFI).

The holders of the Series 1 preferred shares are entitled to receive a non-cumulative fixed dividend in the amount of $0.70 annually per share, payable quarterly, as and when declared by the Board of Directors for the initial period ending October 31, 2019. The quarterly dividend represents an annual yield of 7.0% based on the stated issue price per share. Thereafter, the dividend rate will reset every five years at a level of 543 basis points over the then five year Government of Canada bond yield.

The Bank maintains the right to redeem, subject to the approval of OSFI, up to all of the outstanding Series 1 preferred shares on October 31, 2019 and on October 31 every five years thereafter at a price of $10.00 per share. Should the Bank choose not to exercise its right to redeem the Series 1 preferred shares, holders of these shares will have the right to convert their shares into an equal number of non-cumulative, floating rate Series 2 preferred shares, subject to certain conditions, on October 31, 2019 and on every October 31 every five years thereafter. Holders of Series 2 preferred shares will be entitled to receive quarterly floating dividends, as and when declared by the Board of Directors, equal to the 90-day Government of Canada Treasury bill rate plus 543 basis points.

Upon the occurrence of a trigger event (as defined by OSFI), each Series 1 or 2 preferred shares will be automatically converted, without the consent of the holders, into common shares of the Bank. Conversion to common shares will be determined by dividing the preferred share conversion value ($10.00 per share plus any declared but unpaid dividends) by the common share value (the greater of (i) the floor price of $0.75 and (ii) the current market value price calculated as the volume weighted average trading price for the ten consecutive trading days ending on the day immediately prior to the date of the conversion).

14. Share capital - continued:

Series 3 Preferred shares:

The Bank is authorized to issue an unlimited number of preferred shares, including Series 3 preferred shares with a par value of $10.00. These preferred shares are Basel III-compliant, non-cumulative six year rate reset preferred shares which includes non-viability contingent capital ("NVCC") provisions which would require the preferred shares to be converted to common shares upon a trigger event (as defined by OSFI).

The holders of the Series 3 preferred shares are entitled to receive a non-cumulative fixed dividend in the amount of $0.70 annually per share, payable quarterly, as and when declared by the Board of Directors for the initial period ending April 30, 2021. The quarterly dividend represents an annual yield of 7.0% based on the stated issue price per share. Thereafter, the dividend rate will reset every five years at a level of 569 basis points over the then five year Government of Canada bond yield.

The Bank maintains the right to redeem, subject to the approval of OSFI, up to all of the outstanding Series 3 preferred shares on April 30, 2021 and on April 30 every five years thereafter at a price of $10.00 per share. Should the Bank choose not to exercise its right to redeem the Series 3 preferred shares, holders of these shares will have the right to convert their shares into an equal number of non-cumulative, floating rate Series 4 preferred shares, subject to certain conditions, on April 30, 2021 and on every April 30 every five years thereafter. Holders of Series 4 preferred shares will be entitled to receive quarterly floating dividends, as and when declared by the Board of Directors, equal to the 90-day Government of Canada Treasury bill rate plus 569 basis points.

Upon the occurrence of a trigger event (as defined by OSFI), each Series 3 or 4 preferred shares will be automatically converted, without the consent of the holders, into common shares of the Bank. Conversion to common shares will be determined by dividing the preferred share conversion value ($10.00 per share plus any declared but unpaid dividends) by the common share value (the greater of (i) the floor price of $0.75 and (ii) the current market value price calculated as the volume weighted average trading price for the ten consecutive trading days ending on the day immediately prior to the date of the conversion).

14. Share capital – continued:

b) Issued and outstanding:

(thousands of dollars)

	2018			2017		
	Shares		Amount	Shares		Amount
Common shares:						
Outstanding, beginning of year	21,123,559	$	152,612	20,095,065	$	147,224
Impact of amalgamation with PWC Capital Inc. (note 26)	–		–	1,028,494		5,388
Outstanding, end of year	21,123,559	$	152,612	21,123,559	$	152,612
Series 1 Preferred shares:						
Outstanding, beginning and end of year	1,461,460	$	13,647	1,461,460	$	13,647
Series 3 Preferred shares						
Outstanding, beginning and end of year	1,681,320	$	15,690	1,681,320	$	15,690
Contributed surplus:						
Balance, beginning and end of year		$	145		$	145
Total share capital		$	182,094		$	182,094

There were no transaction costs incurred in the year. In the prior year, the Bank recorded transaction costs of $1.4 million, net of income taxes of $500,000, in share capital (see note 26).

15. Stock-based compensation:

Equity-settled stock options:

The Bank has a stock option plan for its employees and officers. Options are granted at an exercise price set at the closing market price of the Bank's common shares on the day preceding the date on which the option is granted and are exercisable within ten years of issue. Options are usually granted with graded vesting terms. One third of the grant vests immediately, one third vests on the first anniversary of the grant date, and one third vests on the second anniversary date of the grant date. In limited cases, some options are granted with immediate vesting terms.

For the year ended October 31, 2018, the Bank recognized stock-based compensation expense of $nil (2017 - $nil). As at October 31, 2018, the outstanding options totaled 43,851 compared to 46,617 a year ago. The options reflect the options to purchase PWC common shares that were converted into options to purchase Bank common shares pursuant to the amalgamation of the Bank and PWC. The initial 40,000 options granted were to an officer who is a member of the Bank's key management personnel. The options are fully exercisable into common shares at approximately $7.00 per share and expire between 2019 and 2023. No stock options were granted during the year ended October 31, 2018 or October 31, 2017.

16. Restructuring charges:

There were no restructuring charges for the year ended October 31, 2018. Restructuring charges in the prior year related primarily to termination benefits for employees and key management personnel incurred as a function of the sale of the credit card portfolio and the Bank's corporate reorganization.

17. Income taxes:

Income taxes, including both the current and deferred portions, vary from the amounts that would be computed by applying the aggregated statutory federal and provincial tax rate of 27% (2017 – 27%) to income before income taxes. Income taxes have been computed as follows:

(thousands of dollars)

	2018	2017
Income before income taxes	$ 25,013	$ 14,732
Income tax rate	27%	27%
Expected income tax provision	6,754	3,978
Re-measurement of deferred income tax assets subsequent to the Amalgamation	–	(8,831)
Tax rate differential	45	(45)
Other permanent differences	140	158
Income taxes	$ 6,939	$ (4,740)

Income taxes is comprised solely of a deferred income tax provision (recovery).

The components of the recognized deferred income tax assets and related changes, as recognized in net income, equity or accumulated comprehensive income, are as follows:

(thousands of dollars)

	November 1, 2017	Recognized in net income	Recognized directly to equity	October 31, 2018
Allowance for credit losses	$ 639	$ 1	$ –	$ 640
Loss carry forwards	22,137	(6,060)	881	16,958
Share issue and financing costs	508	(219)	–	289
Deposit commissions	(828)	46	–	(782)
Other	2,002	(707)	–	1,295
Total deferred income tax assets	$ 24,458	$ (6,939)	$ 881	$ 18,400

17. Income taxes – continued:

(thousands of dollars)

	November 1, 2016	Recognized in net income	Recognized directly to equity	Acquired on amalgamation with PWC	October 31, 2017
Allowance for credit losses	$ 809	$ (170)	$ –	$ –	$ 639
Loss carry forwards	4,693	4,624	881	11,939	22,137
Share issue and financing costs	499	(491)	500	–	508
Deposit commissions	(835)	7	–	–	(828)
Other	1,232	770	–	–	2,002
Total deferred income tax assets	$ 6,398	$ 4,740	$ 1,381	$ 11,939	$ 24,458

The Bank is subject to Part VI.1 tax which is a 40% tax on dividends paid on taxable preferred shares under the Income Tax Act (Canada). The Part VI.1 tax of $880,000 (2017 - $880,000) and related deferred tax recovery is recorded through equity. Tax adjustments recorded through comprehensive income of $1,000 (2017 - $1,000) are also reflected in equity.

At October 31, 2018, the Bank had income tax losses which can be carried forward to reduce taxable income in future years. These loss carry forwards of the Bank will expire, if unused, as follows:

(thousands of dollars)

2030	$ 6,022
2031	9,926
2032	12,555
2033	13,983
2034	11,419
2035	9,145
2036	-
2037	-
2038	485
	$ 63,535

In addition the Bank has approximately $9.5 million (2017 - $9.5 million) of capital loss carry forwards which may be applied against future capital gains and for which the deferred tax asset of $1.3 million (2017 - $1.3 million) has not been recognized.

18. Per share amounts:

Basic and diluted income per common share

(thousands of dollars except per share amounts)

	2018	2017
Net income	$ 18,074	$ 19,472
Preferred share dividends paid	(2,201)	(2,201)
Net income available to common shareholders	15,873	17,271
Average number of common shares outstanding	21,123,559	20,864,322
Basic and diluted income per common share	$ 0.75	$ 0.83

Employee stock options do not have a dilutive impact as the exercise price is greater than the average market price. The Series 1 and Series 3 NVCC preferred shares are contingently issuable shares and do not have a dilutive impact.

19. Items not involving cash:

(thousands of dollars)

	2018	2017
Provision for (recovery of) credit losses	$ 334	$ (125)
Income taxes	6,939	(4,740)
Interest income	(80,914)	(71,765)
Interest expense	29,415	27,782
Amortization of property and equipment	623	553
	$ (43,603)	$ (48,295)

20. Nature and extent of risks arising from financial instruments:

Risk management involves the identification, ongoing assessment, managing and monitoring of material risks that could adversely affect the Bank. The Bank is exposed to credit risk, liquidity risk, and market risks.

Senior management is responsible for establishing the framework for identifying risks and developing appropriate risk management policies and procedures. The Bank's Board of Directors, either directly or indirectly through its committees, reviews and approves corporate policies, including specific reporting procedures. This enables them to monitor ongoing compliance with policies, delegate limits and review management's assessment of risk in its material risk taking activities. An internal auditor is employed to provide a periodic review of policies and procedures to ensure they are appropriate, effective and being followed and that adequate controls are in place in order to mitigate risk to acceptable levels. The Chief Internal Auditor reports directly to the Audit Committee of the Board of Directors. In addition, the Bank has an ongoing compliance

20. Nature and extent of risks arising from financial instruments – continued:

management program with the Chief Compliance Officer, who reports directly to the Board of Directors, and the Chief Risk Officer, who reports directly to the Risk Oversight Committee.

Credit Risk

Credit risk is the potential for loss due to the failure of a counterparty or borrower to meet its financial obligations. The Bank is exposed to credit risk primarily as a result of its lending activities but also as a result of investing in securities. The Bank manages its lending activity credit risk using policies that have been recommended by the Chief Risk Officer to the Risk Oversight Committee, which then recommends the policies to the Board of Directors for approval. These policies consist of approval procedures and limits on loan amounts, portfolio concentration, geographic concentration, industry concentration, asset category, loans to any one entity and associated groups, a risk rating policy that provides for risk rating each asset in its total asset portfolio, and early recognition of problem accounts (watchlist accounts) with an action plan for each account. The Risk Oversight Committee reviews these policies on an ongoing basis.

The Bank manages its securities credit risk by applying policies that have been recommended by the Chief Risk Officer to the Risk Oversight Committee, which then recommends the policies to the Board of Directors for approval. These policies consist of approval procedures and restrictions in the selection of security dealers, restrictions in the nature of securities selected, and in setting securities portfolio concentration limits. The Risk Oversight Committee reviews these policies on an ongoing basis.

The Risk Oversight Committee, comprised entirely of independent directors, performs the following functions related to credit risk:

- Recommends policies governing management of credit risks to the Board of Directors for approval and reviews credit risk policies on an ongoing basis to ensure they are prudent and appropriate given possible changes in market conditions and corporate strategy.
- Ensures that procedures and controls for managing credit risk are in place.
- Concurs with credits exceeding the levels delegated to management, prior to commitment.
- Reviews, on a regular basis, watchlist accounts, impaired loans and accounts that have gone into arrears.

See note 6 for information relating to credit risk associated with securities and note 7 for information relating to credit risk associated with loans.

There was no material change in the Bank's processes for managing credit risk during the year.

Liquidity Risk

Liquidity risk is the risk that the Bank is unable to meet the demand for cash or is unable to fund obligations as they come due. The Bank is exposed to liquidity risk as a result of timing differences

20. Nature and extent of risks arising from financial instruments – continued:

in the cash flows of its lending activities, security investment activities and deposit taking activities. The Bank has established policies to ensure that its cash outflows and inflows are closely matched and that its sources of deposits are diversified between funding sources and over a wide geographic area. The Risk Oversight Committee recommends policies governing management of liquidity risk to the Board for approval and reviews liquidity policies on an ongoing basis. It receives and reviews quarterly securities portfolio reports and liquidity risk reports from management relating to its liquidity position. Additionally, an Asset Liability Committee, consisting of members of senior management, monitors liquidity risk, reviews compliance with policies and discusses strategies in this area.

See note 21 for information relating to liquidity risk associated with the Bank's asset and liability gaps in maturities.

There was no material change in the Bank's processes for managing liquidity risk during the year.

Market Risk

Market risk is the risk of a negative impact on the balance sheet and/or income statement resulting from changes in market factors such as interest rates or market prices. The Bank's principal market risk arises from interest rate risk as the Bank does not undertake foreign exchange or trading activities. The Risk Oversight Committee is charged with recommending policies that govern market risk to its Board of Directors for approval and with reviewing the policies on an ongoing basis.

Interest rate risk is the risk that a movement in interest rates could negatively impact spread, net interest income and the economic value of assets, liabilities and shareholders' equity. The Bank manages interest rate risk by employing a number of methods including income simulation analysis and interest rate sensitivity gap and duration analysis. Management prepares regular reports to the Board to allow for ongoing monitoring of the Bank's interest rate risk position. The Asset Liability Committee reviews the results of these analyses on a monthly basis and monitors compliance with limits set by corporate policy.

The management of interest rate risk also includes stress testing the Bank's financial assets and liabilities to various standard and non-standard interest rate scenarios. Standard scenarios that are considered include a 100 basis point (bps) parallel upward and downward shift in all yield curves applicable to the Bank.

20. Nature and extent of risks arising from financial instruments – continued:

An analysis of the Bank's sensitivity to an increase or decrease in market interest rates, assuming no asymmetrical movement in yield curves and a static balance sheet is as follows:

Interest Rate Position
(thousands of dollars)

	2018		2017	
	Increase 100 bps	Decrease 100 bps	Increase 100 bps	Decrease 100 bps
Sensitivity of projected net interest income during a 12 month period	$ 2,829	$ (2,802)	$ 3,043	$ (3,060)
Sensitivity of reported equity during a 60 month period	(2,707)	2,857	(1,445)	1,572
Duration difference between assets and liabilities (months)	0.5		0.1	

There was no material change in the Bank's processes for managing interest rate risk during the year.

As at October 31, 2018 and October 31, 2017 the Bank did not have any outstanding contracts to hedge fair value exposure attributed to interest rate risk. The Bank uses on-balance sheet strategies to manage its interest rate risk.

21. Interest rate and liquidity risk:

The Bank is exposed to interest rate risk as a consequence of the mismatch, or gap, between assets and liabilities scheduled to mature or reset on particular dates. The gaps, which existed at October 31, 2018 are as follows:

(thousands of dollars)

	Floating rate	Within 3 months	3 months to 1 year	1 year to 2 years	2 years to 5 years	Over 5 years	Non-interest rate sensitive	Total
Assets								
Cash and cash equivalents	$ 129,781	$ –	$ –	$ –	$ –	$ –	$ –	$ 129,781
Effective rate	2.16%							
Securities	–	–	–	10,017	–	–	–	10,017
Effective rate				2.01%				
Loans	565,347	25,522	74,778	126,858	711,207	123,176	4,138	1,631,026
Effective rate	6.24%	5.91%	5.04%	4.30%	4.85%	4.49%		
Other	–	1,147	–	4,917	–	–	32,242	38,306
Effective rate		1.50%		2.01%				
Total assets	$ 695,128	$ 26,669	$ 74,778	$ 141,792	$ 711,207	$ 123,176	$ 36,380	$1,809,130
Liabilities								
Deposits	$ 361,796	$ 194,449	$ 285,513	$ 296,939	$ 286,057	$ –	$ 12,677	$ 1,437,431
Effective rate	1.06%	1.84%	2.06%	2.17%	2.52%			
Subordinated notes	–	–	–	–	9,844	–	–	9,844
Effective rate					8.77%			
Securitization liabilities	–	–	–	24,591	8,719	–	–	33,310
Effective rate				3.95%	3.55%			
Other	101,504	–	–	–	–	–	3,474	104,978
Effective rate	1.83%							
Equity	–	–	–	13,647	15,690	–	194,230	223,567
Effective rate				7.00%	7.00%			
Total liabilities and equity	$ 463,300	$ 194,449	$ 285,513	$ 335,177	$ 320,310	$ –	$ 210,381	$ 1,809,130
October 31, 2018 gap	$ 231,828	$ (167,780)	$ (210,735)	$ (193,385)	$ 390,897	$ 123,176	$ (174,001)	$ –
Cumulative	$ 231,828	$ 64,048	$ (146,687)	$ (340,072)	$ 50,825	$ 174,001	$ –	$ –
October 31, 2017 gap	$ 271,058	$ (156,271)	$ (220,839)	$ (156,525)	$ 284,007	$ 135,334	$ (156,764)	$ –
Cumulative	$ 271,058	$ 114,787	$ (106,052)	$ (262,577)	$ 21,430	$ 156,764	$ –	$ –

22. Fair value of financial instruments:

The amounts set out in the table below represent the fair value of the Bank's financial instruments:

(thousands of dollars)

	2018		2017	
	Book Value	Fair Value	Book Value	Fair Value
Assets				
Cash and cash equivalents	$ 129,781	$ 129,781	$ 159,909	$ 159,909
Securities	10,017	10,017	262	262
Loans	1,631,026	1,628,472	1,520,857	1,513,175
Other financial assets	6,567	6,567	5,731	5,731
Liabilities				
Deposits	$ 1,437,431	$ 1,412,286	$ 1,376,006	$ 1,365,690
Subordinated notes payable	9,844	10,000	9,786	10,000
Securitization liabilities	33,310	33,736	33,256	34,469
Other financial liabilities	104,978	104,978	97,460	97,460

Fair values are based on management's best estimates of market conditions and valuation policies at a certain point in time. The estimates are subjective and involve particular assumptions and matters of judgment and as such, may not be reflective of future fair values. The Bank's loans and deposits lack an available market as they are not typically exchanged. Therefore, they have been valued as described below and are not necessarily representative of amounts realizable upon immediate settlement.

The fair value amounts have been determined using the following valuation methods and assumptions:

- The fair values of securities are determined based on quoted market prices and internal and external valuation models that incorporate observable market data such as interest rates and credit spreads.
- The fair value of loans is based on net discounted cash flows using market interest rates and applicable credit spreads for borrowers.
- The fair value of deposits is determined based on discounted cash flows using market interest rates.
- The fair value of subordinated notes payable is determined by referring to current values for similar debt instruments.
- The fair value of securitization liabilities is determined based on discounted cash flows using market interest rates.
- The fair value of other financial assets and other financial liabilities is approximately equal to their book value due to the short-term nature of the instruments.

23. Related party transactions:

The Bank's Boards of Directors and Senior Executive Officers represent key management personnel.

At October 31, 2018, amounts due from related parties totalled $672,000 (2017 - $746,000).

The interest rates charged on related party loans are similar to that charged in an arms-length transaction. Interest income earned on related party loans for the year ended October 31, 2018 totalled $23,000 (2017 - $21,000). There were no provisions for credit losses related to loans issued to key management personnel (2017 - $nil).

Total compensation expense recognized for key management personnel for the year was $4.9 million (2017 - $5.7 million).

Prior to the amalgamation in 2017 the Bank paid management and other fees totalling $675,000 to PWC and a subsidiary of PWC.

24. Commitments and contingencies:

a) Credit commitments:

The amount of credit related commitments represents the maximum amount of additional credit that the Bank could be obliged to extend. Under certain circumstances, the Bank may cancel loan commitments at its option. The amount with respect to the letters of credit are not necessarily indicative of credit risk as many of these arrangements are contracted for a limited period of usually less than one year and will expire or terminate without being drawn upon.

(thousands of dollars)

	2018	2017
Loan commitments	$ 167,624	$ 249,682
Letters of credit	42,530	45,442
	$ 210,154	$ 295,124

b) Lease commitments:

The Bank leases a number of premises under operating leases, with current leasing arrangements expiring between June 30, 2019 and January 31, 2045 with an option to renew the leases after the initial lease period. Lease payments are increased every three to five years to reflect market rates. The Bank does not have any material subleases.

24. Commitments and contingencies - continued:

b) Lease commitments (continued):

Total operating lease expense recognized for the year ended October 31, 2018 totalled $983,000 (2017 - $958,000)

Minimum future lease commitments are as follows:

(thousands of dollars)

	2018	2017
Within 1 year	$ 741	$ 560
Between 1 and 5 years	1,549	464
Greater than 5 years	1,017	339
Total lease commitments	$ 3,307	$ 1,363

c) Pledged assets:

In the ordinary course of business, assets are pledged against the following off-balance sheet items:

(thousands of dollars)

	2018	2017
Securitized contracts	$ 4,082	$ 4,049
Letters of credit	6,299	5,905
	$ 10,381	$ 9,954

25. Capital management:

a) Overview

The Bank's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also important and the Bank recognizes the need to maintain a balance between the higher returns that might be possible with greater leverage and the advantages and security afforded by a sound capital position.

OSFI sets and monitors capital requirements for the Bank. Capital is managed in accordance with policies and plans that are regularly reviewed and approved by the Board of Directors and take into account forecasted capital needs and conditions in financial markets.

25. Capital management – continued:

a) Overview (continued):

The goal is to maintain adequate regulatory capital for the Bank to be considered well capitalized, protect consumer deposits and provide capacity for internally generated growth and strategic opportunities that do not otherwise require accessing the public capital markets, all the while providing a satisfactory return to shareholders. The Bank's regulatory capital is comprised of share capital, retained earnings and unrealized gains and losses on available-for-sale securities (Common Equity Tier 1 capital), preferred shares (Additional Tier 1 capital) and the qualifying amount of subordinated notes (Tier 2 capital).

The Bank monitors its capital adequacy and related capital ratios on a daily basis and has policies setting internal maximum and minimum amounts for its capital ratios. These capital ratios consist of the leverage ratio and the risk-based capital ratios.

During the year ended October 31, 2018, there were no material changes in the Bank's management of capital.

b) Risk-Based Capital Ratio:

The Basel Committee on Banking Supervision has published the Basel III rules supporting more stringent global standards on capital adequacy and liquidity (Basel III). OSFI requires that all Canadian banks must comply with the Basel III standards on an "all-in" basis that became effective January 1, 2013 for purposes of determining their risk-based capital ratios. Required minimum regulatory capital ratios are a 7.0% Common Equity Tier 1 (CET1) capital ratio and effective January 1, 2014, an 8.5% Tier 1 capital ratio and 10.5% total capital ratio, all of which include a 2.50% capital conservation buffer. The Basel III rules provide for "transitional" adjustments whereby certain aspects of the new rules will be phased in between 2013 and 2019. The only available transition allowed by OSFI for capital ratios is related to the 10 year phase out of non-qualifying capital instruments.

OSFI also requires banks to measure capital adequacy in accordance with guidelines for determining risk adjusted capital and risk-weighted assets including off-balance sheet credit instruments as specified in the Basel III regulations. Based on the deemed credit risk for each type of asset, assets held by the Bank are assigned a weighting of 0% to 150% to determine the risk-based capital ratio.

25. Capital management – continued:

b) Risk-Based Capital Ratio – continued:

The Bank's risk-based capital ratios are calculated as follows:

(thousands of dollars)

	2018		2017	
	"All-in"	"Transitional"	"All-in"	"Transitional"
Common Equity Tier 1 (CET1) capital				
Directly issued qualifying common share capital	$ 152,757	$ 152,757	$ 152,757	$ 152,757
Retained earnings	41,473	41,473	26,443	26,443
Accumulated other comprehensive income	-	-	4	4
CET1 before regulatory adjustments	194,230	194,230	179,204	179,204
Regulatory adjustments applied to CET1	(20,175)	(16,140)	(26,415)	(21,132)
Total Common Equity Tier 1 capital	$ 174,055	$ 178,090	$ 152,789	$ 158,072
Additional Tier 1 capital				
Directly issued qualifying Additional Tier 1 instruments	$ 29,337	$ 29,337	$ 29,337	$ 29,337
Total Tier 1 capital	$ 203,392	$ 207,427	$ 182,126	$ 187,409
Tier 2 capital				
Directly issued capital instruments subject to phase out from Tier 2	$ 10,000	$ 10,000	$ 10,000	$ 10,000
Tier 2 capital before regulatory adjustments	10,000	10,000	10,000	10,000
Regulatory adjustments applied to Tier 2	(6,000)	(6,000)	(4,000)	(4,000)
Total Tier 2 capital	$ 4,000	$ 4,000	$ 6,000	$ 6,000
Total regulatory capital	$ 207,392	$ 211,427	$ 188,126	$ 193,409
Total risk-weighted assets	$1,502,549	$ 1,506,584	$1,420,276	$ 1,425,559
Capital ratios				
CET1 ratio	11.58%	11.82%	10.76%	11.09%
Tier 1 capital ratio	13.54%	13.77%	12.82%	13.15%
Total capital ratio	13.80%	14.03%	13.25%	13.57%

25. Capital management – continued:

c) Leverage ratio:

The leverage ratio is a supplementary measure to the risk-based capital requirements and is defined as the ratio of Tier 1 capital to its total exposures. The Bank is in compliance with its leverage ratio that is calculated as follows:

(thousands of dollars)

	2018	2017
On-balance sheet assets	$ 1,809,130	$ 1,725,049
Assets amounts deducted in determining the Basel III “all in” Tier 1 capital	(20,175)	(26,415)
Total on-balance sheet exposures	1,788,955	1,698,634
Off-balance sheet exposure at gross notional amount	210,154	295,124
Adjustments for conversion to credit equivalent amount	(123,345)	(182,977)
Off-balance sheet exposures	86,809	112,147
Tier 1 Capital	203,392	182,126
Total exposures	1,875,764	1,810,781
Leverage Ratio	10.84%	10.06%

The Bank was in compliance with the leverage ratio prescribed by OSFI throughout the years presented.

26. Amalgamation of PWC and the Bank:

On January 31, 2017, PWC and the Bank merged by amalgamation. As a result of the amalgamation, at January 31, 2017 the issued and outstanding common shares of the Bank increased by 1,028,494 shares to 21,123,559 common shares. The fair values of the assets and liabilities acquired by the Bank on amalgamation are as follows:

(thousands of dollars)

	January 31, 2017
Incremental assets recognized:	
Cash	$ 1,569
Deferred income tax asset	11,939
Other assets	2,025
Other net liabilities assumed	(8,793)
Transaction costs, net of income taxes of $500	(1,352)
Total impact of amalgamation	$ 5,388