

Basel III Pillar 3 and Leverage Ratio disclosures of

ALTERNA BANK

December 31, 2018

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1. Scope of Application

CS Alterna Bank, a member of the Canada Deposit Insurance Corporation (“CDIC”), operates under the name “Alterna Bank”. It is a Schedule 1 Bank and received letters patent from the Minister of Finance of Canada to operate under the Bank Act on October 2, 2000.

The registered office address of Alterna Bank is 319 McRae, Ottawa, Ontario, K1Z 0B9. The nature of Alterna Bank’s operations and principal activities are the provision of deposit taking facilities and loan facilities to the clients of the bank in Ontario, Quebec and the rest of Canada.

The Pillar 3 and Leverage Ratio Disclosures are unaudited and provide additional summary descriptions and quantitative financial information which supplements those made in Alterna Bank’s audited financial statements for the year ended 31st December 2018. The disclosures produced within this document have been prepared in accordance with minimum disclosure requirements as interpreted by the Office of the Superintendent of Financial Institutions, Canada (‘OSFI’) and established under the OSFI Advisory on Pillar 3 Disclosure Requirements (November 2007), related OSFI guidelines and letters and Basel III leverage ratio framework and disclosure requirements (September 2014).

Comparison with Alterna Bank’s audited financial statements for 2018

The preparation of financial statements in conformity with International Financial Reporting Standards (“IFRS”) requires management to make estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, revenues and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Actual results may differ from management’s estimates.

The financial statements have been prepared on a historical cost basis, except for investments measured at fair value through other other comprehensive income (“FVOCI” under IFRS 9 in 2018, available-for-sale “AFS” under IAS 39 in 2017), derivative financial instruments and financial assets and financial liabilities held at fair value through profit or loss, that have been measured at fair value. Changes in fair value of investments designated as FVOCI (AFS in 2017) are reported in accumulated other comprehensive income (“AOCI”), until sale or impairment occurs, at which time the cumulative gain or loss is transferred to the statements of income.

The Pillar 3 and Leverage Ratio Disclosures have been prepared in accordance with regulatory capital adequacy concepts and rules, rather than in accordance with IFRS. Therefore, some information in the Pillar 3 and Leverage Ratio Disclosures is not directly comparable with the financial information in the Alterna Bank’s audited financial statements for 2018.

Significant subsidiaries

Alterna Bank has no subsidiaries or entities for consolidation.

2. Leverage Ratio

The Leverage Ratio (“LR”) is calculated by dividing Tier I capital by Total Exposure and the regulatory minimum LR requirement for Alterna Bank is 3.0% (2017 – 3.0%). The calculation of Total Exposure is determined by OSFI-prescribed rules and includes on-balance sheet derivatives and other off-balance sheet exposures. The following table summarizes the Bank’s all-in Basel III Pillar 3 Leverage Ratio as at December 31, 2018 and December 31, 2017 as required by OSFI in connection with the 2015 Basel Committee on Banking Supervision Basel III Leverage Ratio Framework and Disclosure Requirement (“BCBS LR Framework”):

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TABLE 1		LEVERAGE RATIO FRAMEWORK		
<i>(thousands of Canadian dollars, except as noted)</i>				
	Item	2018		2017
On-balance sheet exposures				
1	On-balance sheet items (excluding derivatives, SFTs and grandfathered securitization exposures but including collateral)	\$	810,193	\$ 718,407
2	(Asset amounts deducted in determining Basel III “all-in” Tier 1 capital)		–	(6)
3	Total on-balance sheet exposures (excluding derivatives and SFTs) (sum of lines 1 and 2)		810,193	718,401
Derivatives exposures				
4	Replacement cost associated with all derivative transactions (i.e., net of eligible cash variation margin)		34	659
5	Add-on amounts for PFE associated with all derivative transactions		236	153
6	Total derivative exposures (su of lines 4 and 5)		270	812
Other off-balance sheet exposures				
7	Off-balance sheet exposure at gross notional amount		26,721	24,897
8	(Adjustments for conversion to credit equivalent amounts)		(23,960)	(22,249)
9	Off-balance sheet items (sum of lines 7 and 8)	\$	2,761	\$ 2,648
Capital and Total Exposures				
10	Tier 1 Capital	\$	56,624	\$ 48,875
11	Total Exposures (sum of lines 3, 6 and 9)		813,224	721,861
Leverage Ratios				
12	Basel III leverage ratio		7.0 %	6.8 %

The on-balance sheet items exposure as per Table 1 above is reconciled to total assets as per Alterna Bank’s audited financial statements in the table below:

TABLE 2		LEVERAGE RATIO FRAMEWORK – Reconciliation of on-balance sheet exposures to total assets		
<i>(thousands of Canadian dollars, except as noted)</i>				
	Item	2018		2017
	On-balance sheet items (excluding derivatives, SFTs and grandfathered securitization exposures but including collateral)	\$	810,193	\$ 718,407
	Add: Derivative exposures		270	812
	Less: Eligible Stage 1 and Stage 2 allowances		(40)	(68)
	Total Assets as per Alterna Bank’s audited financial statements	\$	810,423	\$ 719,151

3. Capital Structure

OSFI’s regulatory capital guidelines under Basel III allow for two tiers of capital. Tier 1 capital includes Common Equity Tier 1 (“CET1”) capital comprised of common shares, reserves, retained earnings and accumulated other comprehensive income and Additional Tier 1 (“AT1”) capital which includes qualifying additional Tier 1 capital, non-cumulative perpetual preferred shares and regulatory adjustments. Tier 2 capital contains preferred shares, subordinated debt and regulatory adjustments. Alterna Bank’s Tier 1 capital which includes common shares, retained earnings, other comprehensive income and regulatory adjustments for deferred tax assets and credit valuation adjustments (CVA), which are deducted from CET1 capital and Tier 2 capital which includes stage 1 and stage 2 loan allowances.

The risk-based regulatory capital ratios are calculated by dividing CET1, Tier 1 and Total capital by Risk-Weighted Assets (“RWA”). The calculation of RWA is determined by the OSFI-prescribed rules relating to on-balance sheet and off-balance sheet exposures and includes amounts for operational risk exposure associated with the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. In addition, OSFI formally establishes risk-based capital minimums for deposit-taking institutions. These minimums are currently at CET1 capital ratio of 7.0%, Tier 1 capital ratio of 8.5% and a Total capital ratio of 10.5%.

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The table below provides the modified minimum composition of capital disclosures under Basel III as required by OSFI for the year ended December 31, 2018 and December 31, 2017.

TABLE 3		CAPITAL STRUCTURE	
<i>(thousands of Canadian dollars, except as noted)</i>			
	Item	2018	2017
Transitional Common Equity Tier 1 capital: instruments and reserves			
1	Directly issued qualifying common share capital (and equivalent for non-joint stock companies) plus related stock surplus	\$ 40,000	\$ 35,000
2	Retained earnings	16,727	13,160
3	Accumulated other comprehensive income (and other reserves)	(103)	721
4	Common Equity Tier 1 capital before regulatory adjustments	56,624	48,881
Common Equity Tier 1 capital: regulatory adjustments			
5	Total regulatory adjustments to Common Equity Tier 1	—	(6)
6	Common Equity Tier 1 Capital (CET1)	56,624	48,875
Additional Tier 1 capital: regulatory adjustments			
7	Tier 1 capital (T1 = CET1 + AT1)	56,624	48,875
Tier 2 capital: instruments and allowances			
8	Eligible Stage 1 and Stage 2 allowances	40	—
9	Tier 2 capital before regulatory adjustments	40	—
Tier 2 capital: regulatory adjustments			
10	Tier 2 capital (T2)	40	—
11	Total capital (TC = T1 + T2)	\$ 56,664	\$ 48,875
12	Total risk-weighted assets	\$ 163,550	\$ 156,849
Capital ratios			
13	Common Equity Tier 1 (as percentage of risk-weighted assets)	34.6	% 31.2
14	Tier 1 (as percentage of risk-weighted assets)	34.6	31.2
15	Total capital (as percentage of risk-weighted assets)	34.6	31.2
OSFI all-in target			
16	Common Equity Tier 1 capital all-in target ratio	7.0	% 7.0
17	Tier 1 capital all-in target ratio	8.5	8.5
18	Total capital all-in target ratio	10.5	10.5

Alterna Bank is in compliance with the imposed regulatory capital requirements.

4. Capital Adequacy

Under Section 485(1) of the Bank Act and OSFI Guideline A, Alterna Bank must maintain minimum capital requirements to support its ongoing operations. These capital requirements are based on total assets and types of assets that Alterna Bank owns and operational risk arising from its business activities and operating environment. As a general rule, the larger the total assets or riskier the asset types, the greater the capital required. The regulatory minimum leverage ratio for all banks is prescribed by OSFI. As at December 31, 2018, the prescribed regulatory minimum leverage ratio is 3.0%.

In assessing the risk associated with Alterna Bank's assets, OSFI Guideline A provides guidance on the risk weights for each asset type. Capital required for risk-based assets is referred to as the Basel III Pillar 1 risk-based capital requirement. Alterna Bank's policy minimum is set in accordance with its Internal Capital Adequacy Assessment Process ("ICAAP").

Basel III Pillar 1 does not capture all aspects of the overall risk profile and Pillar 2 addresses these limitations. Alterna Bank is tasked with implementing an ICAAP to enhance its capital management practices. Alterna has also developed and employed robust risk management techniques to ensure it has adequate capital in relation to its risk profile and a strategy for maintaining its capital levels. In assessing Alterna Bank's capital requirements, management captures all risks across the enterprise and provides capital accordingly. The capital management planning ensures that the organization is well capitalized to manage in times of economic difficulty.

Alterna Bank uses the standardized approach for credit risk for all on-balance sheet portfolios and the basic indicator approach for all components of operational risk. Alterna Bank does not have any trading book assets or liabilities and therefore no capital is required for market risk.

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The following table provides an overview of the movement in the risk-weighted assets by risk type during the year ended December 31, 2018:

TABLE 4	RISK WEIGHTED ASSETS				
<i>(thousands of Canadian dollars, except as noted)</i>					
Risk weighted assets	Dec 31, 2017	Mar 31, 2018	Jun 30, 2018	Sep 30, 2018	Dec 31, 2018
Credit risk	\$ 146,732	\$ 153,347	\$ 176,866	\$ 163,245	\$ 148,312
Market risk	–	–	–	–	–
Operational risk	10,117	11,507	13,091	14,000	15,238
Total risk weighted assets	\$ 156,849	\$ 164,854	\$ 189,957	\$ 177,245	\$ 163,550

For further information regarding Alterna Bank's risk management framework and processes, please refer to Note 5 of Alterna Bank's 2018 audited financial statements.

5. Credit Risk: General Disclosures

For qualitative disclosures with respect to definitions of past due and impaired loans, description of approaches followed for assessment of individual and collective allowances, and discussion of the credit risk management policy, refer to the following notes to Alterna Bank's 2018 audited financial statements:

Notes:	Reference
Impairment of financial assets	2(e)
Nature and extent of risks arising from financial instruments	5

6. Credit Risk: Disclosures by Counterparty type, Geography and Industry

The following table reconciles the total gross credit exposure to the total assets as per Alterna Bank's audited financial statements for the year ended December 31, 2018 and December 31, 2017:

TABLE 5	RECONCILIATION OF GROSS CREDIT EXPOSURE TO ON-BALANCE SHEET ASSETS			
<i>(thousands of Canadian dollars, except as noted)</i>				
	December 31, 2018		December 31, 2017	
	Total	RWA	Total	RWA
Total Gross Credit Exposure	\$ 790,455	\$ 126,925	\$ 700,305	\$ 127,164
Off-Balance Sheet Gross Credit Exposure	(448)	(116)	(1,128)	(273)
On-Balance Sheet Gross Credit Exposure	790,007	126,809	699,177	126,891
Individual Allowance – Other Retail	(77)	–	(15)	–
On-Balance Sheet Gross Credit Exposure (net of individual allowance)	789,930	126,809	699,162	126,891
Credit Valuation Adjustment phase-in	–	–	–	(41)
Other Assets (not included in Standardized Approach)	20,533	21,387	20,057	19,609
Total Assets subject to Credit Risk (net of individual allowance)	810,463	148,196	719,219	146,459
Eligible Stage 1 and Stage 2 allowances	(40)	–	(68)	–
Operational Risk	–	15,238	–	10,117
Total On-Balance Sheet Assets / Risk Weighted Assets	\$ 810,423	\$ 163,434	\$ 719,151	\$ 156,576

The breakdown of total gross credit exposure by counterparty, and by major types of exposure as at December 31, 2018 and December 31, 2017 is provided in the table below:

TABLE 6	TOTAL GROSS CREDIT EXPOSURE BY COUNTERPARTY TYPE							
<i>(thousands of Canadian dollars, except as noted)</i>								
	December 31, 2018				December 31, 2017			
	Drawn Exposure	Commitments (Undrawn)	OTC Derivatives*	Total	RWAs	Total	RWAs	
Standardized								
Sovereign	\$ 40,499	\$ –	\$ –	\$ 40,499	\$ –	\$ 44,592	\$ –	
Bank	45,034	–	270	45,304	9,061	132,825	26,565	
Corporate	4,819	–	–	4,819	4,819	9,355	9,355	
Retail Residential Mortgages	696,775	178	–	696,953	110,979	510,074	88,789	
Other Retail (excl. SBEs)	2,880	–	–	2,880	2,066	3,459	2,455	
Total Gross Credit Exposure	\$ 790,007	\$ 178	\$ 270	\$ 790,455	\$ 126,925	\$ 700,305	\$ 127,164	

* includes replacement values

The geographic distribution of the total gross credit exposures broken down by major types of credit exposure as at December 31, 2018 and December 31, 2017 is provided in the table below:

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TABLE 7 TOTAL GROSS CREDIT EXPOSURE BY GEOGRAPHY

(thousands of Canadian dollars, except as noted)

Standardized	Drawn Exposure	Commitments (Undrawn)	OTC Derivatives*	December 31, 2018			December 31, 2017		
				Total Exposures	%		Total Exposures	%	
Canada									
Ontario	\$ 431,080	\$ 178	\$ 270	\$ 431,528	54.7	%	\$ 439,012	62.7	%
Quebec	117,952	–	–	117,952	14.9		113,591	16.2	
British Columbia	144,502	–	–	144,502	18.3		86,108	12.3	
Alberta	62,786	–	–	62,786	7.9		34,018	4.9	
Saskatchewan	18,980	–	–	18,980	2.4		12,712	1.8	
Manitoba	9,601	–	–	9,601	1.2		6,681	1.0	
Nova Scotia	1,721	–	–	1,721	0.2		5,523	0.8	
Newfoundland	1,517	–	–	1,517	0.2		1,632	0.2	
New Brunswick	1,671	–	–	1,671	0.2		824	0.1	
Prince Edward Island	197	–	–	197	0.0		204	0.0	
Total Gross Credit Exposure	\$ 790,007	\$ 178	\$ 270	\$ 790,455	100.0	%	\$ 700,305	100.0	%

* includes replacement values

The industry distribution of total gross credit exposure broken down by major types of credit exposure as at December 31, 2018 and December 31, 2017 is provided in the table below:

TABLE 8 TOTAL GROSS CREDIT EXPOSURE BY INDUSTRY

(thousands of Canadian dollars, except as noted)

Standardized	Drawn Exposure	Commitments (Undrawn)	OTC Derivatives*	December 31, 2018			December 31, 2017		
				Total Exposures	%		Total Exposures	%	
Sovereign	\$ 40,499	\$ –	\$ –	\$ 40,499	5.1	%	\$ 44,592	6.4	%
Bank									
Financial Services	45,034	–	270	45,304	5.7		132,825	19.0	
Corporate									
Financial Services	390	–	–	390	0.0		4,088	0.6	
Real Estate	4,429	–	–	4,429	0.6		4,917	0.7	
Services	–	–	–	–	–		350	0.0	
Other	–	–	–	–	–		–	–	
Retail Residential Mortgages	696,775	178	–	696,953	88.2		510,074	72.8	
Retail (excl. SBEs)	2,880	–	–	2,880	0.4		3,459	0.5	
Total Gross Credit Exposure	\$ 790,007	\$ 178	\$ 270	\$ 790,455	100.0	%	\$ 700,305	100.0	%

* includes replacement values

For residual contractual maturity of the total portfolio segregated by major types of credit exposure, refer to Note 5 of Alterna Bank's 2018 audited financial statements.

The lifetime expected credit losses ("ECL") on the credit-impaired loans were approximately \$6,024,000 (2017 – \$885,000) or 0.763% (2017 – 0.126%) of total gross credit exposure at December 31, 2018. Therefore, no additional disclosures related to industry and geographic areas of these loans have been presented. For the accounting policy on the measurement of the ECL, refer to Note 2(e) of Alterna Bank's 2018 audited financial statements.

For credit-impaired loans and reconciliation of changes in the loss allowance, refer to Note 3 and Note 5 of Alterna Bank's 2018 audited financial statements.

7. Credit Risk: Disclosures for Portfolios Subject to the Standardized Approach

The External Credit Assessment Institutions ("ECAI") used by Alterna Bank are Dominion Bond Rating Service ("DBRS") and Standard & Poor's ("S&P"). DBRS and S&P ratings are recognized by OSFI as eligible ECAI's and are used to assess the credit quality of all exposure classes, where applicable, using the credit quality assessment scale that is set out by OSFI in its Guideline A 'Capital Adequacy Requirement ("CAR") – Simpler Approaches'. It is Alterna Bank's Investment/Derivative policy that all investments held must be rated 'A' or better by DBRS or S&P.

The table below provides the amount of bank's outstanding credit exposure in each risk bucket.

TABLE 9 TOTAL GROSS CREDIT EXPOSURE SUBJECT TO STANDARDIZED APPROACH BY RISK WEIGHT

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(thousands of Canadian dollars, except as noted)

	December 31, 2018						December 31, 2017	
	Risk Weight	Drawn Exposure	Commitments (Undrawn)	OTC Derivatives*	Total	RWA	Total	RWA
Standardized								
Sovereign	0 %	\$ 40,499	\$ –	\$ –	\$ 40,499	\$ –	\$ 44,592	\$ –
Bank								
AAA to AA-	20	45,034	–	270	45,304	9,061	132,825	26,565
Corporate								
AAA to AA-	20	–	–	–	–	–	–	–
BBB+ to BB- or Unrated	100	4,819	–	–	4,819	4,819	9,355	9,355
Retail Residential								
Qualifying Insured	0	365,878	–	–	365,878	–	248,717	–
Qualifying Insured	20	32,613	–	–	32,613	6,523	17,915	3,583
Qualifying Uninsured	35	298,284	178	–	298,462	104,456	243,442	85,206
Other Retail **	20	88	–	–	88	18	232	46
Other Retail **	75 %	2,792	–	–	2,792	2,048	3,227	2,409
Total Gross Credit Exposure		\$ 790,007	\$ 178	\$ 270	\$ 790,455	\$ 126,925	\$ 700,305	\$ 127,164

* includes replacement values

** RWA based on net credit exposure of 2,818

8. Credit Risk Mitigation

General qualitative disclosures with respect to credit risk mitigation are presented in Note 5(a) of Alterna Bank's 2018 audited financial statements. The following information gives details of the exposure (including those on balance sheet and/(or) off-balance sheet, where netting is not applicable) covered by eligible financial collateral and by guarantees/credit derivatives.

TABLE 10 TOTAL GROSS CREDIT EXPOSURE, FINANCIAL COLLATERAL AND GUARANTEE
(thousands of Canadian dollars, except as noted)

Standardized	December 31, 2018						December 31, 2017		
	Total	RWA	Financial Collateral	Guarantee	Total	RWA	Financial Collateral	Guarantee	
Sovereign	\$ 40,499	\$ –	\$ –	\$ –	\$ 44,592	\$ –	\$ –	\$ –	
Bank	45,304	9,061	–	–	132,825	26,565	–	–	
Corporate	4,819	4,819	–	–	9,355	9,355	–	–	
Retail Residential									
Mortgages	696,953	110,979	–	398,490	510,074	88,789	–	266,632	
Other Retail (excl. SBEs)	2,880	2,066	88	–	3,459	2,455	232	–	
Total Gross Credit Exposure	\$ 790,455	\$ 126,925	\$ 88	\$ 398,490	\$ 700,305	\$ 127,164	\$ 232	\$ 266,632	

9. Counterparty Credit Risk

All of Alterna Bank's derivative contracts are Over-the-Counter ("OTC") call option contracts that are privately negotiated between Alterna Bank and the counterparty to the contract.

For qualitative and quantitative disclosures relating to fair value methodology, hierarchical classification, credit risk mitigation and maturities of derivative portfolio, refer to the following notes to Alterna Bank's 2018 audited financial statements:

Notes:	Reference
Derivatives and Hedging	2(h)
Fair Value of Financial Instruments	20
Nature and Extent of Risks arising from Financial Instruments	5
Derivative Financial Instruments	21

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10. Operational Risk

Alterna Bank has adopted the basic indicator approach in determining its operational risk capital requirement.

Operational risk is the risk of loss resulting from failed or inadequate infrastructure, including internal or outsourced processes, people, information technology, and customer management.

Operational risk is inherent in all of its activities, including the practices and controls used to manage other risks such as credit, market, and liquidity risk. Failure to manage operational risk can result in significant financial loss, reputational harm, or regulatory disapproval and penalties.

Alterna Bank has established policies that have been approved by the Board to manage and control operational risk. The Board policies govern the activities relating to oversight of business continuity, incident management and operational processes pertaining to third party, data, financial crime and fraud, on-going projects, technology, information and cyber security. Operations and the handling of day-to-day risks are the responsibility of management. In this regard, detailed operating procedures have been developed to successfully execute business strategies, operate efficiently and provide reliable, secure, and convenient access to financial services. One of the key controls built into the procedures is the concept of segregation of duties, whereby transactions of any consequence require the interaction of more than one person. Furthermore, appropriate insurance policies are used as a risk mitigation strategy where appropriate to lower risk.

11. Remuneration

Alterna Bank is a wholly-owned subsidiary of Alterna Savings and Credit Union Limited, a credit union operating in the province of Ontario. Alterna Bank due to its small size and to reduce its need for capital expenditures outsources certain management and other services to assist in conducting its business. These services are provided by Alterna Savings, and are identified in the Outsourcing Agreement between Alterna Bank and Alterna Savings.

There are no executives employed by Alterna Bank; rather, executive services are included in the Outsourcing Agreement. Payments for these services include those made to executives overseeing branch operations and finance. Compensation costs attributable to other senior executives, such as the President & CEO, Senior Vice President & Chief Administrative Officer, and Senior Vice President & Chief Information Officer are allocated to Alterna Bank as part of an overhead component attached to the price charged by Alterna Savings for various transactions.

The employees of Alterna Bank are governed by the remuneration policies of Alterna Savings. In addition to their salaries, Alterna Bank's employees participate in Alterna Saving's group benefits plans (which provides certain health care, dental care, life insurance, and other benefits), as well as Alterna Savings' pension plan and corporate bonus plan.

Alterna Savings' executive compensation program is overseen by the Governance Committee of its Board (the "Committee"). The Committee is comprised of five (5) Directors, they convene at a minimum on a quarterly basis, and in 2018 one meeting was held at which compensation matters were addressed. The Committee, among other duties, is responsible for reviewing the remuneration structure for Alterna Savings' executive management to the Alterna Savings Board of Directors, as defined in an Executive Compensation Policy (the "Policy"). The objectives of the Policy address the key risks related to remuneration and are as follows: support the attraction and retention of high caliber executives; provide competitive total rewards that encourage high levels of group and individual performance, and align the interests of Alterna Savings' executives with those of its members. The Policy is reviewed annually by the Committee for approval by the Board of Directors. The current year Policy review was completed on December 7, 2018.

Alterna Savings' executives participate in a short-term incentive plan ("STIP") based on key organizational value drivers that include, but are not limited to, financial and strategic measures. The STIP is offered at the discretion of the CEO and Board of Directors. The Board of Directors may seek the advice of external compensation experts to ensure that total remuneration for executives remains aligned with the Policy. Alterna Savings currently doesn't have a long-term incentive plan.

For the different forms of remuneration that Alterna Bank utilizes and for quantitative disclosures, refer to Note 25(a) of its 2018 audited financial statements.