
CANADIAN TIRE BANK

BASEL III PILLAR 3 DISCLOSURES

As at December 31, 2018

(unaudited)



CANADIAN TIRE BANK

BASEL III PILLAR 3 DISCLOSURES

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1. SCOPE OF APPLICATION

Basis of preparation

This document represents the Basel III Pillar 3 disclosures for Canadian Tire Bank (“the Bank”). The Basel III Pillar 3 disclosures included herein are made solely to meet the Office of the Superintendent of Financial Institutions Canada (“OSFI”) November 2007 requirements regarding the Basel Committee on Banking Supervisions update on “Basel II: International Convergence of Capital Measurement and Capital Standards: A Revised Framework – Comprehensive Version,” and “Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems.” The amounts disclosed in the tables below are the balance sheet carrying amounts included in the consolidated financial statements of the Bank prepared in accordance with International Financial Reporting Standards (“IFRS”) and using the accounting policies described therein.

The Basel III capital adequacy framework prescribed by OSFI is applied to the consolidated operations of the Bank, which include the Bank and a structured entity, Glacier Credit Card Trust (“GCCT”). The Bank is a wholly owned subsidiary of CTFS Holdings Limited (“CTFS Holdings”), itself a subsidiary of Canadian Tire Services Limited, formerly Canadian Tire Financial Services Limited, (“CTS”) which owns eighty percent of the common shares of CTFS Holdings. CTS is a wholly owned subsidiary of Canadian Tire Corporation, Limited (“CTC”). The Bank is not considered a Domestically-Systematically Important Bank (D-SIB) by OSFI.

The Bank engages primarily in the business of originating, financing and managing credit card and other loans receivable and accepting deposits in high-interest savings accounts, including tax free accounts and guaranteed investment certificates. In addition, the Bank provides credit card settlement services to Canadian Tire and its affiliates and markets a variety of financial and insurance products to Canadian Tire customers.

This report is unaudited and is reported in thousands of Canadian Dollars, unless otherwise disclosed.

Transferability of capital

The Bank's capital is funded by its own capital issuance and profit retention. As part of its capital management process, the Bank seeks to maintain a prudent level of capital that supports its planned business growth and regulatory requirements.

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Risk Management Framework

The Board of Directors has oversight responsibility for the Bank's risk management framework.

- Responsible for oversight of the Bank's financial statements, financial reporting processes and the quality of its financial reporting including the accounting principles, significant judgments and disclosures.
- Responsible for oversight of the risk management functions of the Bank with the assistance of and reporting by the Chief Risk Officer.
- Responsible for approving appropriate and prudent risk management policies (including tolerance limits) to mitigate business risks. This includes but is not limited to approving the Bank's Risk Appetite Framework.

Management has established the below committees in order to identify and monitor existing and emerging risks faced by the Bank, set out the appropriate controls and risk limits, and establish processes for monitoring adherence to these limits.

- Asset Liability Management Committee ("ALCO"),
 - Provides oversight to ensure the Bank's balance sheet risks (including liquidity and funding, capital, interest rate risk, foreign exchange and securities and derivatives) are managed within established risk tolerance limits.
 - Monitors financial market conditions and regulatory changes impacting balance sheet risks.
- Cross – Functional Risk Committee ("CRC")
 - Oversees the management of the Bank's principal risks including identification, assessment and monitoring of risks and promotes an integrated and effective risk management culture.
 - Review regular risk management reports describing outstanding risks issues and risk mitigation activities.

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2. CAPITAL STRUCTURE

OSFI's regulatory capital guidelines under Basel III allow for two tiers of capital. Common Equity Tier 1 ("CET1") capital includes common shares, retained earnings and accumulated other comprehensive income, less regulatory adjustments which are deducted from capital. The Bank currently does not hold any additional Tier 1 capital instruments, therefore, the Bank's CET1 is equal to its Tier 1 regulatory capital. Tier 2 capital consists of the eligible portion of general allowances.

		2018	2017
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	\$ 431,631	\$ 431,631
2	Retained Earnings	433,716	656,998
3	Accumulated other comprehensive income (and other reserves)	(1,820)	9,392
6	Common Equity Tier 1 capital before regulatory adjustments	863,527	1,098,021
Common Equity Tier 1 capital: regulatory adjustments			
28	Total regulatory adjustments to Common Equity Tier 1	(68,396)	(26,428)
29	Common Equity Tier 1 capital (CET1)	\$ 795,132	\$ 1,071,593
Additional Tier 1 capital: instruments			
36	Additional Tier 1 capital before regulatory adjustments	-	-
Additional Tier 1 capital: regulatory adjustments			
43	Total regulatory adjustments to Additional Tier 1 capital	-	-
44	Additional Tier 1 capital (AT1)	-	-
45	Tier 1 capital (T1 = CET1 + AT1)	\$ 795,132	\$ 1,071,593
Tier 2 Capital: Instruments and Provisions and Regulatory Adjustments			
51	Tier 2 capital before regulatory adjustments	42,317	-
Tier 2 capital: regulatory adjustments			
57	Total regulatory adjustments to Tier 2 capital	-	-
58	Tier 2 capital (T2)	42,317	-
59	Total capital (TC = T1 + T2)	\$ 837,448	\$ 1,071,593
60	Total risk-weighted assets	\$ 5,349,631	\$ 5,780,375
Capital ratios			
61	Common Equity Tier 1 (as percentage of risk-weighted assets)	14.9%	18.5%
62	Tier 1 (as percentage of risk-weighted assets)	14.9%	18.5%
63	Total capital (as percentage of risk-weighted assets)	15.7%	18.5%
OSFI target			
69	Common Equity Tier 1 capital target ratio	7.0%	7.0%
70	Tier 1 capital target ratio	8.5%	8.5%
71	Total capital target ratio	10.5%	10.5%

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3. CAPITAL ADEQUACY

The Bank manages its capital under guidelines established by OSFI and uses both internal and regulatory minimum capital ratio targets to monitor its capital base. OSFI's capital and leverage guidelines measure capital in relation to credit, market and operational risks and provide an overall measure of the adequacy of an institution's capital. The Bank has various capital policies, procedures and controls, including an Internal Capital Adequacy Assessment Process ("ICAAP"), which it utilizes to achieve its goals and objectives. The ICAAP is reviewed and approved by the Board of Directors annually. The Bank's objectives include:

- Providing sufficient capital to maintain the confidence of investors and depositors;
- Being an appropriately capitalized institution, as measured internally, defined by regulatory authorities and compared with the Bank's peers.

Capital and leverage ratios

The capital and leverage ratios are prescribed in OSFI's Capital Adequacy Requirements and Leverage Requirements Guidelines. The capital ratios are calculated as regulatory capital divided by risk-weighted assets ("RWA"). The leverage ratio is calculated as Tier 1 capital divided by the leverage ratio exposure.

RWA includes: a credit risk component for all on- and off-balance sheet assets and financial instruments; an operational risk component based on a percentage of average risk-weighted revenues; and a market risk component for assets held for trade. For the purpose of calculating RWA, securitization transactions are considered off-balance sheet transactions and therefore securitization assets are not included in the RWA calculation.

The Bank uses the standardized approach for credit risk for all on-balance sheet portfolios, the current exposure method for off-balance sheet financial instruments, the basic indicator approach for all components of operational risk, and the standardized approach for market risk. The Bank is not required to hold any capital in relation to market risk as the Bank does not have assets classified as held for trade.

The leverage ratio exposure is the sum of on-balance sheet exposures, derivatives exposures, securities financing transactions exposures, and off-balance sheet items. The components of the leverage ratio exposure are presented in Note 16.

As at December 31, 2018 and 2017, the Bank complied with all regulatory capital guidelines established by OSFI and its internal targets as determined by its ICAAP.

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4. CREDIT RISK: GENERAL DISCLOSURES

Credit risk is the risk of financial loss resulting from the failure of a debtor, for any reason, to fully honour its financial contractual obligations to the Bank. This is the most significant financial risk exposure faced by the Bank and arises principally from the Bank's loans receivable.

Objectives, policies and processes

The objective of the Bank's credit risk management program is to manage its risk within an appropriate tolerance and to maximize the overall return on the risks taken.

The Bank's Credit Risk Management Policy establishes how the Bank manages credit risks incurred through its business activities. The Board of Directors have overall responsibility for the Credit Risk Management Policy by ensuring that management has a framework and policies, processes and procedures in place to manage credit risks and that the overall credit risk policies are complied with at the business transaction level. The Bank's Credit Risk Management Policy is comprised of the following categories:

- Approval Authorities
- Risk Tolerance Limits
- Credit Risk Identification
- Credit Granting and Collection
- Impaired Loans, Allowance and Write-offs

Concentrations of credit risk

Concentrations of credit risk exist if a number of customers are engaged in similar activities, are located in the same geographic region or have similar economic characteristics such that their ability to meet contractual obligations could be similarly affected by changes in economic, political or other conditions. Concentrations of credit risk indicate a related sensitivity of the Bank's performance to developments affecting a particular counterparty, industry or geographic location. The Bank uses sophisticated credit scoring models, monitoring technology and collection modeling techniques to implement and manage strategies, policies and limits that are designed to control risk. Loans receivable are generated by a large and geographically dispersed group of customers primarily within Canada. Current credit exposure is limited to the loss that would be incurred if all of the Bank's counterparties were to default at the same time.

Risk measurement

The Bank maintains comprehensive procedures and information systems to effectively monitor and control the characteristics and quality of its credit portfolio. To ensure the Bank's credit granting, documentation and collection processes are followed correctly, the Bank maintains the following:

- A credit rating system that defines risk-rating criteria and rates all credits individually according to those criteria
- Portfolio characteristic monitoring
- Credit review processes
- Independent inspections of its credit portfolio to ensure compliance

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Credit risk by exposure type

	2018	2017
Investment securities		
Government debt securities	\$ 283,546	\$ 251,333
Bank and corporate debt securities	172,939	140,445
Loans receivable ¹	5,484,125	5,567,549
Total	\$ 5,940,610	\$ 5,959,327

¹ Net loans receivable including securitized loans

Credit risk by contractual maturity

	As at December 31, 2018					Total
	Less than 3 months	3 months to 1 year	1 to 3 years	3 to 5 years	>5 years	
Investment securities						
Government debt securities	\$ 31,741	\$ 99,117	\$ 107,865	\$ 44,824	\$ -	\$ 283,546
Bank and corporate debt securities	172,939	-	-	-	-	172,939
Loans receivable ¹	5,484,125	-	-	-	-	5,484,125
Total	\$ 5,688,806	\$ 99,117	\$ 107,865	\$ 44,824	\$ -	\$ 5,940,610

¹ Net loans receivable including securitized loans

Allowance for credit losses

ECL is calculated as the product of the probability of default, exposure at default, and loss given default over the remaining expected life of the financial instrument and discounted to the reporting date. The ECL model also incorporates forward-looking information, which increases the degree of judgment required as to how changes in macro-economic factors will affect ECLs. Macro-economic factors taken into consideration include, but are not limited to, unemployment rate, and require an evaluation of both the current and forecast direction of the macro-economic cycle. The methodologies and assumptions, including any forecasts of future economic conditions, are reviewed regularly.

The ECL approach measures the loss allowance using a three-stage approach based on the extent of credit deterioration since origination:

- Stage 1 – Where there has not been a significant increase in credit risk since initial recognition of a financial instrument, an amount equal to 12-month ECL is recorded, which represents the portion of lifetime ECL that is expected to result from default events that are possible within 12 months after the reporting date.
- Stage 2 – Financial instruments that have experienced a significant increase in credit risk subsequent to origination but are not in default, an amount equal to lifetime ECL is recorded. Lifetime ECL represents the expected losses that will result from all probable default events over the expected life of a financial instrument.
- Stage 3 – Financial instruments that are considered to be in default (credit impaired) are included in this stage. Similar to Stage 2, the allowance is recognized at lifetime ECL.

A significant increase in credit risk is assessed based on changes in the probability of default since initial recognition along with borrower-specific qualitative information, or when the loan is 30 days past due. Credit card loans are considered impaired and in default when they are contractually 90 days past due or there is sufficient doubt about the ultimate collectability of principal and/or interest.

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The Bank recognizes a loss allowance on a forward-looking basis at an amount equal to the lifetime ECL on its financial assets measured at amortized cost, except for the following, which are measured at 12-month ECL:

- Debt investments that are determined to have low credit risk at the reporting date with a credit risk rating equivalent to investment grade; and
- Other financial assets, such as loan receivables, for which credit risk has not increased significantly since initial recognition.

All loans receivable are assessed for impairment. All loans receivable found not to be specifically impaired are then collectively assessed for impairment. Loans receivables are collectively assessed for impairment by grouping together loans receivable with similar risk characteristics.

Allowance for credit losses

	12-month ECL (Stage 1)	Lifetime ECL not credit-impaired (Stage 2)	Lifetime ECL credit-impaired (Stage 3)	Total
Allowance for credit losses, beginning of year	\$ 226,967	\$ 182,321	\$ 294,707	\$ 703,996
Write Offs	(11,941)	(25,569)	(361,864)	(399,374)
Recoveries	-	-	75,360	75,360
New loans originated	53,955	-	-	53,955
Transfers				
to Stage 1	73,209	(50,615)	(22,594)	-
to Stage 2	(32,479)	36,630	(4,151)	-
to Stage 3	(28,193)	(26,796)	54,988	-
Net re-measurement	(28,504)	70,108	289,090	330,695
Allowance for credit losses, end of year	\$ 253,013	\$ 186,080	\$ 325,538	\$ 764,631

The Bank continues to seek recovery on the majority of amounts that were written-off during the year. The Bank pursues recovery unless it no longer has the right to collect, the receivable has been sold to a third party, or all reasonable efforts to collect have been exhausted.

The following table sets out information about the credit risk exposure of loans receivables at December 31, 2018:

	(Stage 1)	(Stage 2)	(Stage 3)	Total
Low risk	\$ 2,119,169	\$ 210,569	\$ -	\$ 2,329,738
Moderate risk	1,864,398	251,939	-	2,116,337
High risk	836,613	290,427	675,641	1,802,681
Total gross carrying amount	4,820,180	752,935	675,641	6,248,756
ECL allowance	253,013	186,080	325,538	764,631
Net carrying amount	\$ 4,567,167	\$ 566,855	\$ 350,103	\$ 5,484,125

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Past due loans

A loan is considered past due when a customer has not made the indicated payment by the contractual due date. The following table presents the carrying value of loans that are past due. Credit card loans are written down to their net realizable value when a payment is 180 days in arrears or when likelihood of collection is remote. No collateral is held against loans receivable.

	As at December 31, 2018			
	1-30 days	31-90 days	> 90 days	Total
Loans receivable	\$ 223,692	\$ 89,040	\$ 73,978	\$ 386,710

5. CREDIT RISK: DISCLOSURES FOR PORTFOLIOS SUBJECT TO THE STANDARDIZED APPROACH

Credit ratings are obtained from three rating agencies - DBRS Limited ("DBRS"), Standard & Poor's ("S&P") and Moody's Investor Service ("Moody's"). Investment securities consist of bank, corporate and government debt securities. Investment securities have risk-weightings from 0% to 100% based on their credit rating. Loans receivable primarily consist of credit card loans and have a risk-weighting of 75%. Net securitization exposures are risk-weighted at 1250%. Off-balance sheet financial instruments consist of foreign exchange and interest rate derivatives and are risk weighted from 20% to 100% according to their counterparty of their credit equivalent amount, which is determined by multiplying the notional amount by a credit conversion factor specified by OSFI.

Risk-weighted assets by exposure type

	Risk Weighting	2018	2017
On-balance sheet assets			
Government debt securities	0%	\$ -	\$ -
Bank and corporate debt securities	20% - 100%	34,588	28,089
Derivative instruments	20% - 100%	8,824	4,283
Off-balance sheet financial instruments			
Foreign exchange derivatives	100%	\$ 902	\$ 687
Interest rate derivatives	20%	1,300	500

6. CREDIT RISK: DISCLOSURES FOR PORTFOLIOS SUBJECT TO THE INTERNAL RATINGS-BASED APPROACH

The Bank does not have any portfolios subject to the Internal Ratings-Based Approach ("IRB").

7. CREDIT RISK MITIGATION

Loans receivable consist of credit card and other loans receivable. The loans are unsecured and are not guaranteed. Investment securities are subject to the policies, procedures and controls as described in Note 8.

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8. COUNTERPARTY CREDIT RISK

Counterparty credit risk is the risk that the counterparty to a transaction may default prior to the final settlement of the cash flows pertaining to that transaction. This may relate to financial derivatives, securities financing transactions and long settlement transactions.

The Bank's Credit Risk Management and Securities and Derivatives Policies establish how the Bank manages counterparty credit risks incurred through its business activities. The Board of Directors has overall responsibility for the Credit Risk Management and Securities and Derivatives Policies by ensuring that management has a framework and policies, processes and procedures in place to manage counterparty credit risks and that the overall counterparty credit risk policies are complied with at the business transaction level. The Bank is committed to ensuring the preservation of capital and maintaining adequate liquidity to meet cash flow requirements. The Bank does not invest or enter into derivative transactions for speculative purposes. Counterparty credit risk will be minimized by:

- Setting minimum acceptable credit ratings for investments
- Setting maximum group limits for related issuers
- Limiting investments to higher credit quality fixed income securities with a maximum maturity of five years
- Diversifying the portfolio so that potential losses on individual securities are minimized

Counterparty credit risk exposure

	2018	2017
On-balance sheet exposure		
Government debt securities	\$ 283,546	\$ 251,333
Bank and corporate debt securities	\$ 172,939	140,445
Derivative instruments	\$ 31,183	21,359
Off-balance sheet exposure (notional amount)		
Foreign exchange derivatives	\$ 54,764	\$ 43,414
Interest rate derivatives	\$ 1,980,000	900,000

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9. SECURITIZATION

The Bank acts as originator and liquidity provider to its own securitizations. The Bank uses securitization to diversify funding sources and for capital efficiency purposes. The Bank will also from time-to-time invest in third party high quality short term asset-backed commercial paper investment securities.

The consolidated financial statements include the financial statements of the Bank and GCCT as explained below. Strictly for the purpose of calculating RWA, securitization transactions are considered off-balance sheet transactions and therefore securitization assets are not included in the RWA calculation. The Bank uses the standardized approach for securitization exposures.

GCCT is a structured entity that was created to securitize the Bank's credit card loans receivable. The Bank has transferred co-ownership interest in credit card loans receivable to GCCT and has determined, for the purposes of accounting, consolidation of GCCT is appropriate. The associated liabilities secured by these assets, include the commercial paper notes and term notes on the consolidated statement of financial position and are carried at amortized cost. The table below sets out the carrying amounts and fair values of the Bank's transferred credit card loan receivables and associated liabilities.

	2018		2017	
	Carrying value	Fair value	Carrying value	Fair value
Credit card loans receivable transferred	\$ 2,438,157	\$ 2,438,157	\$ 1,915,090	\$ 1,915,090
Associated liabilities	2,432,758	2,419,204	1,910,458	1,903,261
Net position	\$ 5,399	\$ 18,953	\$ 4,632	\$ 11,829

For legal purposes, the co-ownership interests in the Bank's receivables that are owned by GCCT have been sold at law to GCCT and are not available to the creditors of the Bank.

The Bank has not identified any factors arising from current market circumstances that could lead to a need for the Bank to extend liquidity and/or credit support to GCCT over and above the existing arrangements or that could otherwise change the substance of the Bank's relationship with GCCT. There have been no changes in the capital structure of GCCT since the Bank's assessment for consolidation.

Commercial paper notes

The asset-backed commercial paper notes are short-term notes issued by GCCT as financing for the 1997-1 series securitization deal. These commercial paper notes have varying original maturities of 364 days or less at interest rates fixed at the time of each renewal. The notes may bear interest payable at maturity or be sold at a discount and mature at face value. Commercial paper notes issued by GCCT are recorded at amortized cost.

Series 1997-1 notes will be repaid either through the application of collections distributed to GCCT in respect of the series 1997-1 ownership interest or by issuing replacement notes and applying the proceeds to repay existing notes, or some combination of the two. The series 1997-1 notes will also be subject to early repayment if any of the events listed below occur.

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Term notes

Term notes are made up of senior notes and subordinated notes issued by GCCT with an original maturity of three to five years.

	Expected Repayment Date	Coupon Interest Rate	2018	2017
Senior Notes				
Series 2013-1	November 20, 2018	2.755%	\$ -	\$ 250,000
Series 2014-1	September 20, 2019	2.568%	472,500	472,500
Series 2015-1	September 20, 2020	2.237%	465,000	465,000
Series 2016-A	October 12, 2021	Variable	1	1
Series 2017-1	September 20, 2022	2.048%	523,600	523,600
Series 2018-1	September 20, 2023	3.138%	546,000	-
			2,007,101	1,711,101
Subordinated notes				
Series 2013-1	November 20, 2018	3.275%	-	14,551
Series 2014-1	September 20, 2019	3.068%	27,500	27,500
Series 2015-1	September 20, 2020	3.237%	35,000	35,000
Series 2017-1	September 20, 2022	3.298%	36,400	36,400
Series 2018-1	September 20, 2023	4.138%	37,958	-
			136,858	113,451
Transaction costs			(5,565)	(4,711)
			\$ 2,138,394	\$ 1,819,841

Asset-backed series senior and subordinated notes issued by GCCT are recorded at amortized cost. Transaction costs related to the issuance of the notes are netted against the carrying value of the notes and amortized over the expected life of the notes as part of the interest expense.

Subject to the payment of certain priority amounts, the series senior notes have recourse on a priority basis to the related series ownership interest. The series subordinated notes have recourse to the related series ownership interests on a subordinated basis to the series senior notes in terms of the priority of payment of principal and interest. The series notes, together with certain other permitted obligations of GCCT, are secured by the assets of GCCT. The entitlement of note holders and other parties to such assets is governed by the priority and payment provisions set forth in the GCCT Indenture and the related series supplements under which these series of notes were issued.

Repayment of the principal of the series 2014-1, 2015-1, 2016-A, 2017-1, and 2018-1 notes is scheduled to commence and be completed on the expected repayment dates indicated in the preceding table. Following repayment of principal owing, and in some circumstances interest, under the series senior notes, collections distributed to GCCT in respect of the related ownership interests will be applied to pay principal owing under series subordinated notes.

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Principal repayments may commence earlier than these scheduled commencement dates if certain events occur, including:

- a) The Bank failing to make required distributions to GCCT, or failing to meet covenant or other contractual terms;
- b) The performance of the receivables failing to achieve set criteria; and
- c) Insufficient receivables in the pool.

None of these events have occurred for the years ending December 31, 2018 and 2017.

10. MARKET RISK: STANDARDIZED APPROACH

Market risk is the risk of loss that may arise from changes in market factors such as interest rates and foreign exchange rates.

Objectives, policies and processes

It is the Bank's objective to effectively and efficiently manage its consolidated statement of financial position in order to maximize shareholder value within risk limits established in the Asset Liability Management Policy. This policy dictates foreign exchange risk limits.

The Bank's principal risk arises from interest rate risk (discussed in Note 14) and foreign exchange risk. Interest rate contracts are used to hedge future securitization transactions that are expected to be completed within the next five years. Foreign exchange contracts are used to hedge contractual commitments in a foreign currency.

The Asset Liability Management Policy dictates the following foreign exchange risk limits in the Bank:

- Approved currencies are restricted to Canadian dollars and United States dollars ("USD").
- Approved transactions are restricted to spots, forwards and swaps.
- Maximum maturity of foreign exchange contracts is 18 months. The Bank's President can approve hedges greater than 18 months provided a contractual commitment in a foreign currency exists.
- The foreign exchange hedge limits are:
 - Hedge a minimum of 75% of the forecast foreign exchange requirements for the period one to six months forward.
 - Hedge a minimum of 25% and a maximum of 75% of the forecast foreign exchange requirements for the period seven to 12 months forward.
 - Hedge a maximum of 50% of the forecast foreign exchange requirements for the period 13 to 18 months forward.

The standardized approach is used for the market risk component for assets held for trade. Assets are classified as held for trade when they are held with trading intent. The Bank does not have assets classified as held for trade nor does it hold any derivative financial instruments for speculative purposes. Therefore the Bank is not required to hold any capital in relation to market risk.

The Bank is in compliance with its foreign exchange risk limits as at December 31, 2018 and 2017.

11. MARKET RISK: INTERNAL MODELS APPROACH

The Bank does not use the internal models approach ("IMA") for trading portfolios.

12. OPERATIONAL RISK

The Bank uses the basic indicator approach for operational risk. Operational risk is based on a percentage of average risk-weighted revenues.

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13. EQUITIES

The Bank holds equity investments that are recorded at \$nil cost as the shares were awarded at no cost, are not quoted in an active market and their fair value cannot be reliably measured.

14. INTEREST RATE RISK

Interest rate risk reflects the Bank's financial sensitivity to movements in interest rates. Interest rate exposure may produce favourable or unfavourable effects depending on the nature of the exposure, and the direction and volatility of interest rate fluctuations. Interest rate exposure is affected by the interest rate sensitivity of assets and liabilities.

Objectives, policies and processes

It is the Bank's objective to effectively and efficiently manage its consolidated statement of financial position in order to maximize shareholder value within risk limits established in the Asset Liability Management Policy. This policy dictates interest rate risk limits.

The Asset Liability Management Policy dictates the following interest rate risk limits for a plus or minus 200 bps parallel shift in interest rates in the Bank:

- Projected net interest income may decline by no more than 6% (2017 – 6%)
- Net economic value of equity ("EVE") may decline by no more than 12% (2017 – 12%)

EVE is defined as the present value of assets less the present value of liabilities.

The Bank mitigates its interest rate risks as it enters into hedging contracts in accordance with the guidelines in the Bank's Asset Liability Management Policy to hedge securitization and deposit issuances that are expected to be completed within the next five years.

The following table provides the projected impact of a 200 bps decrease or increase in interest rates.

	Limit	2018		2017	
		-200 bps	+200 bps	-200 bps	+200 bps
Net Interest Income	-6%	0.7%	-0.8%	0.6%	-1.3%
Net Economic Value of Equity	-12%	-5.3%	14.4%	-1.7%	4.8%

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15. LIQUIDITY AND FUNDING RISK

Liquidity and funding risk is the risk that the Bank may be unable to generate or obtain sufficient cash or its equivalent in a timely and cost-effective manner to meet its commitments as they come due.

Objectives, policies and processes

It is the Bank's objective to ensure the availability of adequate funds by maintaining a strong liquidity management framework and to satisfy all applicable regulatory and statutory requirements. The Asset Liability Management Policy dictates liquidity and funding limits and requires the establishment of an annual Liquidity and Funding Plan which includes risk measurement methodologies, scenario analysis, stress testing and also provides roles, responsibilities and key actions in managing a liquidity crisis. Stress tests are conducted on a regular basis for a variety of bank-specific and market-wide stress scenarios to identify sources of potential strain, to measure the impact on funding requirements and to ensure that current exposures remain in accordance with the Bank's established liquidity and funding risk tolerance. Stress test scenarios include disruption to the securitization funding market, immediate terminations within broker deposits, unexpected and persistent withdrawals of retail deposits, and balance sheet growth greater than forecast.

The Asset Liability Management Policy dictates that the Bank must maintain a minimum liquidity coverage ratio of 110% (2017 – 110%). The liquidity coverage ratio measures the amount of liquid assets available to offset net cash outflows over a 30 day period that could occur under an acute short term stress scenario.

The Bank's liquidity coverage ratio at December 31, 2018 was 124% (2017 –129%).

The Bank assesses the adequacy of its liquidity position by analyzing its current liquidity position, present and anticipated funding requirements, and alternative sources of funds. Future cash inflows and outflows as well as the above noted ratio are forecast daily.

The Bank maintains a variety of funding sources to reduce the concentration risk from any one source. The Bank's funding sources include cash from operations, securitization of credit card loans receivable, broker deposits, retail deposits, intercompany borrowings, and committed credit facilities.

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16. LEVERAGE RATIO

The following summarizes the Bank's leverage ratio.

		2018	2017
On-balance sheet exposures			
1	On-balance sheet items (excluding derivatives, SFTs and grandfathered securitization exposures but including collateral)	\$ 6,208,092	\$ 6,089,458
2	(Asset amounts deducted in determining Basel III Tier 1 capital)	(68,396)	(26,428)
3	Total on-balance sheet exposures (excluding derivatives and SFTs) (sum of lines 1 and 2)	\$ 6,139,696	\$ 6,063,030
Derivative exposures			
4	Replacement cost associated with all derivative transactions (ie net of eligible cash variation margin)	\$ 31,183	\$ 21,359
5	Add-on amounts for PFE associated with all derivative transactions	7,402	3,187
6	Gross up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the operative accounting framework	-	-
7	(Deductions of receivables assets for cash variation margin provided in derivative transactions)	-	-
8	(Exempted CCP-leg of client cleared trade exposures)	-	-
9	Adjusted effective notional amount of written credit derivatives	-	-
10	(Adjusted effective notional offsets and add-on deductions for written credit derivatives)	-	-
11	Total derivative exposures (sum of lines 4 to 10)	\$ 38,585	\$ 24,546
Securities financing transaction exposures			
16	Total securities financing transaction exposures (sum of lines 12 to 15)	-	-
Other off-balance sheet exposures			
17	Off-balance sheet exposure at gross notional amount	\$ 10,973,149	\$ 9,690,140
18	(Adjustments for conversion to credit equivalent amounts)	(9,875,834)	(8,721,126)
19	Off-balance sheet items (sum of lines 17 and 18)	\$ 1,097,315	\$ 969,014
Capital and Total Exposures			
20	Tier 1 capital	\$ 795,132	\$ 1,071,593
21	Total Exposures (sum of lines 3, 11, 16 and 19)	\$ 7,275,596	\$ 7,056,590
Leverage Ratios			
22	Basel III leverage ratio	10.9%	15.2%

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17. REMUNERATION

The Bank follows the remuneration policies of its ultimate parent CTC. The Management Resources and Compensation committee of the CTC Board of Directors is responsible for the oversight of CTC's compensation structure for senior management including salaries, annual and long-term incentive plans and plans involving share issuances and share unit awards.

Key management personnel compensation

	2018	2017
Salaries and other short-term employee benefits	\$ 3,175	\$ 2,909
Other long-term benefits	217	237
Share-based payment transactions	1,345	2,371
Termination benefits	-	33
Directors fees, expenses and share unit plan	471	450
	\$ 5,208	\$ 6,000

In addition to their salaries, the Bank's employees participate in the employee future benefit plan of CTC, which provides certain health care, dental care, life insurance and other benefits, but not pensions, to employees upon retirement. Employees also participate in stock-based compensation plans operated by CTC.

Senior management also participate in a short-term incentive plan ("STIP") and long-term incentive plan ("LTIP") operated by CTC.

The objective of the STIP is to motivate and reward senior managers for the achievement of annual operating and financial goals. Evaluation of individual performance is based on the achievement of established individual objectives that are aligned to key areas of strategic focus and are critical to the achievement of CTC's business strategy. In determining the payout under the STIP plan, performance is measured against both financial and non-financial measures to avoid inappropriate risks.

The objective of the LTIP is to align the interests of senior managers with the achievement of CTC's long-term business objectives as well as with the interests of shareholders. LTIP is awarded for achieving CTC consolidated operating earnings, same store sales, and relative total shareholder return targets over a three-year period.

Full details of CTC's compensation arrangements can be found in the Management Information Circular, available on the CTC Investor Relations website.