MCAN Financial



MCAN FINANCIAL GROUP

BASEL III PILLAR 3 DISCLOSURES

DECEMBER 31, 2023

1. Scope of Application

This document represents the Basel III Pillar 3 Disclosures Report for MCAN Mortgage Corporation d/b/a MCAN Financial Group (the "Company", "MCAN" or "we") at December 31, 2023. These disclosures are made pursuant to the Pillar 3 Disclosure Guideline for Small and Medium-Sized Deposit-Taking Institutions ("SMSBs") Capital and Liquidity Requirements of the Office of the Superintendent of Financial Institutions ("OSFI") as MCAN is a Category II SMSB. Additional information can be found on OSFI's Financial Data for Loan Companies website: https://www.osfi-bsif.gc.ca/Eng/wt-ow/Pages/FINDAT-lc.aspx. For further qualitative disclosure, refer to our 2023 Annual Report, on the System for Electronic Document Analysis and Retrieval at www.sedarplus.ca or the Company's website at www.mcanfinancial.com.

The amounts disclosed in the tables below represent the carrying amounts included in the Company's consolidated financial statements at and for the year ended December 31, 2023, which are prepared in accordance with International Financial Reporting Standards ("IFRS") and use the accounting policies described therein. This document is unaudited and is reported in thousands of Canadian dollars, unless otherwise noted.

The Basel III capital adequacy framework is applied to the consolidated operations of the Company, which include the Company's wholly-owned subsidiary, MCAN Home Mortgage Corporation.

MCAN is a Loan Company under the *Trust and Loan Companies Act* (Canada) (the "Trust Act") and a Mortgage Investment Corporation ("MIC") under the *Income Tax Act* (Canada) (the "Tax Act"). As a Loan Company under the Trust Act, the Company is subject to the guidelines and regulations set by OSFI. MCAN is incorporated in Canada with its head office located at 200 King Street West, Suite 600, Toronto, Ontario, Canada. MCAN is a public company listed on the Toronto Stock Exchange under the symbol MKP.

MCAN Home Mortgage Corporation is an originator of residential mortgage products across Canada.

The Company generates a reliable stream of income by investing in a diversified portfolio of Canadian mortgages, including residential, residential construction, non-residential construction and commercial loans, as well as other types of securities, loans and real estate investments, including our investment in MCAP Commercial LP ("MCAP"). The Company employs leverage by issuing term deposits that are eligible for Canada Deposit Insurance Corporation deposit insurance and are sourced through a network of independent financial agents. Leverage can be up to a maximum of five times capital (on a non-consolidated tax basis in the MIC entity) as limited by the provisions of the Tax Act applicable to a MIC. The Company also participates in the National Housing Act mortgage-backed securities program.

2. Capital Structure and Capital Adequacy

The Company's Common Equity Tier 1 ("CET 1") capital consists of share capital, contributed surplus and retained earnings. The Company does not hold any additional Tier 1 capital instruments; therefore, its CET 1 capital is equal to its Tier 1 capital. The Company's Tier 2 capital consists of Stage 1 and Stage 2 mortgage allowances calculated under IFRS. Total Capital equals CET 1 or Tier 1 capital plus Tier 2 capital.

The Company's authorized share capital consists of an unlimited number of common shares with no par value. As at December 31, 2023, the Company had 35,431,938 common shares outstanding.

As a Loan Company under the Trust Act, OSFI oversees the adequacy of the Company's capital. OSFI requires all federally regulated institutions to meet the minimum capital to risk-weighted asset ("RWA") ratios of 7% CET 1 capital, 8.5% Tier 1 capital and 10.5% Total capital and a minimum leverage ratio which is calculated on a different basis from the MIC leverage ratio. The risk-weighting of all on-balance sheet assets and all off-balance sheet assets is based on a prescribed percentage of the underlying asset position, in addition to adjustments for other items such as impaired mortgages. Risk-weighted assets also include an operational risk charge, which is based on certain components of the Company's net investment income over the past 12 quarters. The Company uses the standardized approach for credit risk and the basic indicator approach for operational risk. The Company maintains internal target minimum CET 1, Tier 1 and Total capital ratios.

The Company maintains prudent capital planning practices to ensure that it is adequately capitalized and continues to satisfy minimum standards and internal targets. In conjunction with the annual strategic planning and budgeting process, the Company completes an Internal Capital Adequacy Assessment Process ("ICAAP") in order to ensure that it has sufficient capital to support its business plan and risk appetite. The ICAAP assesses the capital necessary to support the various inherent risks that the Company faces, including liquidity and funding, credit, interest rate, market, operational, regulatory compliance, strategic and reputational risks. The Company's business plan is also stress tested under various adverse scenarios to determine the impact on its results from operations and financial condition. The ICAAP is reviewed by both management and the Board of Directors (the "Board") and is submitted to OSFI annually. In addition, the Company performs stress testing on its internal forecasts for capital adequacy on a quarterly basis, and the results of such testing are reported to the Board.

The Company's key metrics are outlined in the table below. OSFI's Pillar 3 Disclosure Guideline for SMSBs Capital and Liquidity Requirements prescribes standardized row numbers when disclosing certain capital information to facilitate comparability across regulated entities.

Table 1: Key metrics

(in thousands except %) At	OSFI ROW #	Q4 2023	Q3 2023	Q2 2023	Q1 2023	Q4 2022
Available capital (amounts)						
CET 1	1	$ 473,661	$ 470,235	$ 458,495	$ 448,818	$ 432,466
CET 1 capital with transitional arrangements for ECL provisioning not applied[1]	1a	$ 473,661	$ 470,235	$ 458,495	$ 448,818	$ 432,249
Tier 1	2	$ 473,661	$ 470,235	$ 458,495	$ 448,818	$ 432,466
Tier 1 capital with transitional arrangements for ECL provisioning not applied[1]	2a	$ 473,661	$ 470,235	$ 458,495	$ 448,818	$ 432,249
Total capital	3	$ 481,614	$ 476,987	$ 464,776	$ 453,945	$ 437,658
Total capital with transitional arrangements for ECL provisioning not applied[1]	3a	$ 481,614	$ 476,987	$ 464,776	$ 453,945	$ 437,798
RWA (amounts)						
Total RWA	4	$2,689,764	$2,653,164	$2,561,986	$2,291,149	$2,206,580
Risk-based capital ratios as a percentage of RWA						
CET 1 ratio	5	17.61 %	17.72 %	17.90 %	19.59 %	19.60 %
CET 1 ratio with transitional arrangements for ECL provisioning not applied[1]	5a	17.61 %	17.72 %	17.90 %	19.59 %	19.59 %
Tier 1 ratio	6	17.61 %	17.72 %	17.90 %	19.59 %	19.60 %
Tier 1 ratio with transitional arrangements for ECL provisioning not applied[1]	6a	17.61 %	17.72 %	17.90 %	19.59 %	19.59 %
Total capital ratio	7	17.91 %	17.98 %	18.14 %	19.81 %	19.83 %
Total capital ratio with transitional arrangements for ECL provisioning not applied[1]	7a	17.91 %	17.98 %	18.14 %	19.81 %	19.83 %
Additional CET1 buffer requirements as a percentage of RWA						
Capital conservation buffer requirement	8	2.50 %	2.50 %	2.50 %	2.50 %	2.50 %
Total CET1 specific buffer requirements	11	2.50 %	2.50 %	2.50 %	2.50 %	2.50 %
CET1 available after meeting the minimum capital requirements	12	10.61 %	10.72 %	10.90 %	12.59 %	12.60 %
Basel III leverage ratio						
Total Basel III leverage ratio exposure measure	13	$4,993,777	$4,816,699	$4,720,824	$4,515,607	$4,400,532
Basel III leverage ratio (row 2 / row 13)	14	9.49 %	9.76 %	9.71 %	9.94 %	9.83 %
Basel III leverage ratio (row 2a / row 13) with transitional arrangements for ECL provisioning not applied[1]	14a	9.49 %	9.76 %	9.71 %	9.94 %	9.82 %

[1] *Effective March 31, 2020, the total capital ratio reflects the inclusion of stage 1 and stage 2 allowances on the Company's mortgage portfolio in Tier 2 capital. In accordance with OSFI's transitional arrangements for capital treatment of ECL issued March 27, 2020, a portion of stage 1 and stage 2 allowances that would otherwise be included in Tier 2 capital are included in CET 1 capital. The adjustment to CET 1 capital was measured each quarter as the increase, if any, in stage 1 and stage 2 allowances compared to the corresponding allowances at December 31, 2019. The increase, if any, was subject to a scaling factor that decreased over time and was 25% in fiscal 2022.*

The Company's total balance sheet exposures, regulatory capital and leverage ratio are outlined in the table below. OSFI's Pillar 3 Disclosure Guideline for SMSBs Capital and Liquidity Requirements prescribes standardized row numbers when disclosing certain capital information to facilitate comparability across regulated entities.

Table 2: Leverage ratio common disclosure

(in thousands except %) **At December 31, 2023**	**OSFI ROW #**		
On-balance sheet items	1	$	4,740,987
Asset amounts deducted in determining Tier 1 capital	4		(58,183)
Total on-balance sheet exposures	5		4,682,804
Mortgages and non-marketable securities funding commitments	17		716,638
Less: adjustments for conversion to credit equivalent amount	18		(429,983)
Letters of credit	17		48,637
Less: adjustments for conversion to credit equivalent amount	18		(24,319)
Off-balance sheet items (sum of rows 17 and 18)	19		310,973
Tier 1 capital	20		473,661
Total Exposures (sum of rows 5 and 19)	21	$	4,993,777
Basel III Leverage Ratio	22		9.49 %

The Company's regulatory capital information at December 31, 2023 is outlined in the table below. OSFI's Pillar 3 Disclosure Guideline for SMSBs Capital and Liquidity Requirements prescribes standardized row numbers when disclosing certain capital information to facilitate comparability across regulated entities.

Table 3: Composition of capital

(in thousands except %) **At December 31, 2023**	**OSFI ROW #**		
Share capital and contributed surplus	1	$	407,038
Retained earnings	2		124,708
Accumulated other comprehensive income	3		98
CET 1 capital before regulatory adjustments	6		531,844
Total regulatory adjustments to CET 1 capital	28		(58,183)
CET 1 capital	29		473,661
Tier 1 capital	45		473,661
Collective allowances	50		7,953
Tier 2 capital	58		7,953
Total capital	59	$	481,614
Total risk-weighted assets	60	$	2,689,764
Regulatory Capital Ratios			
CET 1 capital to risk-weighted assets ratio	61		17.61 %
Tier 1 capital to risk-weighted assets ratio	62		17.61 %
Total capital to risk-weighted assets ratio	63		17.91 %
OSFI Target			
CET 1 target ratio	69		7.00 %
Tier 1 capital target ratio	70		8.50 %
Total capital ratio	71		10.50 %

3. Credit Risk

Credit risk is the risk of financial loss resulting from the failure of a counterparty, for any reason, to fully honour its financial or contractual obligations to the Company, primarily arising from our investments and lending activities. Fluctuations in real estate values may increase the risk of default and may also reduce the net realizable value of the collateral property to the Company. These risks may result in defaults and credit losses, which may result in a loss of earnings.

Credit risk is managed through risk management policies and procedures that emphasize the quality and diversification of our investments and lending activities. Credit policies include credit risk limits in alignment with the Risk Appetite Framework. These credit risk limits include, but are not limited to, concentration by asset class, geographic region, dollar amount and borrower. These policies are amended on an ongoing basis and approved by the Board to reflect changes in market conditions and risk appetite.

The Capital Commitments Committee, which is comprised of management, is accountable for decision-making on credit risk issues and provides oversight of proposed investments for the construction, commercial and marketable and non-marketable securities portfolios.

Credit and commitment exposure are closely monitored by operational and oversight business units. The Risk and Compliance Committee, which is comprised of management, monitors and challenges credit risk exposures, monitors portfolio and underwriting quality and performance against credit risk limits on a monthly basis. The Enterprise Risk Management and Compliance Committee reviews all material risks affecting the Company on a quarterly basis, which includes the identification, assessment, and monitoring of material credit risks.

The Company identifies potential risks in our mortgage portfolio by way of regular review of market and portfolio metrics, which are a key component of quarterly market reports provided to the Board by management. Existing risks in our mortgage portfolio are identified by arrears reporting, portfolio diversification analysis, post funding monitoring and risk rating trends of the entire mortgage portfolio. The aforementioned reporting and analysis provide adequate monitoring of and control over our exposure to credit risk.

The Company assigns a credit score and risk rating for all mortgages at the time of underwriting based on the assessed credit quality of the borrower and the value of the underlying real estate. Risk ratings are reviewed annually at a minimum, and more frequently whenever there is an amendment, or a material change such as a default or impairment.

As part of the Company's credit risk management process, the Company monitors its loan portfolio for early indicators of potential concern. The "monitored/arrears" category includes construction and commercial loans that may experience events such as slow sales, cost overruns or are located in geographic markets in which risks have arisen. Loans in this category are included in stage 2. Considering factors such as borrower equity, portfolio loan to value ratios and project liquidity, at December 31, 2023, there have been no indications at the portfolio level of potential loss of principal in excess of the allowances for credit losses recorded for mortgages in stage 1 and 2. These collective allowances are based on forward-looking economic assumptions and other factors.

As a response to economic uncertainty, the Company has increased the frequency of monitoring and reporting of our credit risk profile, including enhanced arrears reporting and pipeline monitoring. Real estate prices have been, and may continue to be, impacted by inflationary pressures on the economy and higher interest rates, which may adversely impact the ability of borrowers to make timely payments on mortgages.

The maximum credit exposure on our individual financial assets is equal to the carrying value of the respective assets, except for our corporate mortgage portfolio, where maximum credit exposure also includes outstanding commitments for future mortgage fundings and our investments in non-marketable securities, where maximum credit exposure includes our total remaining commitments.

4. Operational Risk

Operational risk is the potential for loss resulting from people, inadequate or failed internal processes, systems, or from external events.

The Operational Risk Management Framework ("ORMF") covers all components of MCAN's operational risk management including processes and control activities to ensure adherence with business and regulatory requirements. The ORMF sets out an integrated approach to identify, measure, monitor, manage and report on known and emerging operational risks. Management and the Board review operational risk on a quarterly basis.

Third Party Risk

Within operational risk, third party risk is the risk of third parties failing to provide goods and services or otherwise carrying out activities in accordance with their arrangements. This risk also considers similar risks as it relates to fourth and fifth parties. We outsource the majority of our construction and commercial mortgage origination, mortgage servicing and collections to MCAP and other third parties. There is a risk that the services provided by third parties will fail to adequately meet our standards and expose MCAN to negative outcomes.

The Company's Outsourcing Policy incorporates the relevant requirements of OSFI Guideline B-10, Outsourcing of Business Activities, Functions and Processes. We regularly review our outsourced contracts to determine if an arrangement is material and to assess the overall risk inherent in that contract. All outsourced contracts are subject to a risk management program, which includes detailed monitoring activities. If an outsourced contract is material, it is subjected to an enhanced risk management program.

Technology and Cyber Security Risk

Technology risk encompasses the risk of IT systems, tools, and practices being unable to support business and user needs. Cyber security risk is the risk of loss of confidentiality, integrity, or availability of information, data, or information (or control) systems as a result of actions taken by internal or external malicious actors. In particular, the cybersecurity threat landscape remains elevated globally, where threat actors are increasingly utilizing sophisticated tools and technologies to disrupt business operations. Any such system failure or material data loss, either accidental through misconfiguration or purposeful through threat actors, could generate disruption to business practices, create financial loss, and damage MCAN's reputational risk profile.

The IT Management Committee, which is comprised of executive management, is accountable for overseeing technology and cybersecurity risk management activities and reports cyber security, system performance, and technology change management risks to the Audit Committee. Likewise the Vice President, IT reports on the technology and cyber risk profile to the Audit Committee on a quarterly basis. We also leverage third parties to provide cyber security insurance, incremental technical expertise, infrastructure and security monitoring support, and periodic cyber security assessment assistance, such as vulnerability/penetration testing and broader risk assessments. These activities are complemented by crisis management plans, including a Cyber Security Incident Response Plan, Disaster Recovery Plan, and process-level Business Continuity Plans, all of which are supported by an executive Crisis Management Team.

Strategically, MCAN continues to invest in its technology and data infrastructure to enhance operational processes, resiliency, cyber security, analytical capabilities, and digital-first customer offerings.

Borrower Fraud Risk

In the loan underwriting process, we rely on information provided by potential borrowers and other third parties, including mortgage brokers and insurers. We may also rely on the representations of potential borrowers and third parties as to the accuracy and completeness of that information. Our financial performance may be negatively impacted if this information is intentionally misleading or does not fairly represent the financial condition of the potential borrower.

We frequently review and continuously enhance our underwriting procedures and control processes to strengthen our ability to detect such inaccurate and misleading information and to manage this risk. These enhancements include improvements to

underwriting staff training, broker and insurer engagement, independent income verification procedures, and other quality control and quality assurance processes.

MCAN controls and monitors for borrower misrepresentation and maintains awareness of industry reported instances of mortgage fraud. To date, document falsification has not had a material impact on MCAN or its financial position or performance. Nonetheless, MCAN acknowledges that the likelihood of borrower misrepresentation may increase as mortgage qualification requirements tighten. MCAN maintains a robust internal control environment to mitigate borrower fraud.

Reliance on Key Personnel

Our future performance is dependent on the abilities, experience and efforts of our management team and other key personnel. There is no assurance that we will be able to continue to attract and retain key personnel, although it remains a key objective of the Company. Should any key personnel be unwilling or unable to continue their employment with MCAN, there may be an adverse effect on our financial condition and results of operations.