A N N U A L   R E P O R T   2 0 1 7

FIRST NATIONAL

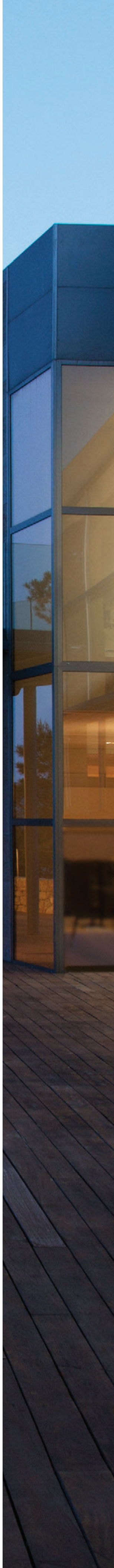
FINANCIAL CORPORATION

PERFORMANCE AT A GLANCE

First National was founded on March 31, 1988 by Stephen Smith and Moray Tawse, two Canadian entrepreneurs who shared a vision for creating value in mortgage lending. At its inception, the company operated from a single location above a storefront in mid-town Toronto and was financed, in part, by funds from a home mortgage.

While much has changed over the past 30 years as First National has grown to become Canada's largest non-bank mortgage lender with approximately 950 employees, much has remained the same. Our founders continue to be deeply engaged, our company is focused solely on mortgage lending and as an experienced, entrepreneurial group, we know that our success is still dependent on how well we serve our customers.

In this, our 30th year of doing business, we are proud of our roots as a Canadian company, but prouder still of the relationships we have built with generations of customers across the country.



#1

First National is Canada's largest non-bank mortgage lender and largest commercial mortgage lender.

$100 Billion

In 2017, Mortgages Under Administration (MUA) exceeded $100 billion for the first time, representing approximately 290,000 residential accounts and over 5,000 commercial borrowers.

$1.1 Billion

Amount of dividends and distributions First National has paid to common shareholders since its initial public offering in 2006.

$205.3 Million

Net income attributable to common shareholders increased 4% in 2017, providing support for record common share dividends of $184.4 million.

$1.25

First National paid a special dividend in December 2017 of $1.25 per common share in addition to its regular monthly common share dividends.

11

The number of times our Board has increased the common share dividend since First National's 2006 initial public offering.

38%

The after-tax, Pre-Fair Market Value (1) return on shareholders' equity in 2017 demonstrates the efficiency of First National's business model.

469%

The cumulative yield from dividends, distributions and capital appreciation earned by a shareholder between First National's initial public offering in June 2006 and December 31, 2017.

[1] Non-IFRS Measure. See MD&A for more details.

CORPORATE **PROFILE**

First National Financial Corporation (TSX: FN, TSX: FN.PR.A, TSX:FN.PR.B) is the parent company of First National Financial LP, a Canadian-based originator, underwriter and servicer of predominantly prime residential (single-family and multi-unit) and commercial mortgages. With over $100 billion in Mortgages Under Administration, First National is Canada's largest non-bank originator and underwriter of mortgages, and is among the top three in market share in the mortgage broker distribution channel. More information can be found in this annual report and at **firstnational.ca**.

OUR MANAGEMENT TEAM

From left to right
Rick Votano, Vice President, Information Technology
Lisa White, Senior Vice President, Mortgage Operations
Scott McKenzie, Senior Vice President, Residential Mortgages
Stephen Smith, Co-founder, Chairman and Chief Executive Officer
Moray Tawse, Co-founder and Executive Vice President
Jeremy Wedgbury, Senior Vice President, Commercial Mortgages
Robert Inglis, Chief Financial Officer
Jason Ellis, Senior Vice President and Managing Director, Capital Markets
Hilda Wong, Senior Vice President and General Counsel

LETTER FROM THE **CEO**

Fellow Shareholders:

We will remember 2017 as the year First National surpassed $100 billion in Mortgages Under Administration. This milestone was three decades in the making and reflects the cumulative efforts of First National employees to provide Canadians and their mortgage advisors with a competitive set of products and value-added services, supported by leading technology.

Mortgages Under Administration is the source of most of the company's earnings, so it is an important operating metric. It is also a proxy for our market position. While Canadian residential mortgage markets are dominated by Canada's largest banks, First National is quite clearly the country's largest non-bank mortgage lender with $77.4 billion of single-family Mortgages Under Administration at year-end. The remaining amount, $24.2 billion, consists of multi-unit residential and commercial mortgages. In context, we believe this makes First National the country's largest commercial mortgage lender with loans on a wide variety of high-quality assets.

We will also remember 2017 as a year of strong financial performance. All-time highs were reached in revenue ($1.1 billion), net income ($209.7 million) and common share dividends ($184.4 million or $3.08 per share). As a result of our efficient business model, after-tax Pre-Fair Market Value return on shareholders' equity was 38%.

As a lender and as a publicly traded corporation, consistency and longevity matter, so we are pleased to note that this was First National's 29th consecutive year of profitable operations and the 11th straight year (since our initial public offering) that we paid our common share dividend, raising it 11 times along the way. Since the IPO, almost

$1.1 billion in total dividends and distributions have been paid to holders of our common equity. On a per share basis, First National has delivered over $18 per share of dividends and distributions to common shareholders who purchased ownership at the IPO for $10 per unit.

In many ways, 2017 was another good year to be a mortgage lender. The Canadian economy began to improve with higher employment levels recorded in many regions. As employment is a key driver of real estate market activity, this created momentum for the business, as did the continuation of a low interest rate environment. Although we did see two increases from the Bank of Canada in July and September, the overnight rate at year-end was still significantly below the 4.5% it reached in November 2007 before the financial crisis.

The stimulus provided by low interest rates and ongoing population expansion in our major cities also created concerns for policymakers as house prices escalated and consumer debt mounted. Policy interventions – which acted as headwinds for our industry and First National – came in various forms and from various levels of government.

In the fall of 2016, the Department of Finance Canada introduced a stress test for borrowers of five-year, fixed-rate, high-ratio mortgages and eliminated insurability on single-family refinancing transactions. Early in 2017, the Office of the Superintendent of Financial Institutions (OSFI) implemented new minimum capital adequacy standards for mortgage default insurers. Ontario and British Columbia's provincial governments also reacted to a decline in housing affordability by applying a foreign buyers' tax. These demand-side interventions modestly reduced the size of our market, increased competition for available opportunities and in the case of insurance premiums, increased costs making some portfolio insurance uneconomical.

As a result, First National's new single-family mortgage originations were 10% or $1.3 billion lower in 2017 than in 2016. First National offset the impact of this decline on Mortgages Under Administration – as well as the maturity of several Commercial Mortgage-Backed Securities (CMBS) transactions – by taking advantage of opportunities to renew $5.2 billion of single-family mortgages, about $650 million more than in 2016. The commercial team also contributed with record new originations of $5.8 billion (21% more than in 2016) and renewals of $1.1 billion (up 16% year over year).

The ability to fully embrace the highest underwriting standards required of Canada's largest financial institutions and then to efficiently and effectively adjust our lending activities to comply, have long been competitive advantages for First National. These advantages have provided the foundation for resilient growth in our book over market cycles, and encouraged our team to search for workable solutions for borrowers. They are also central to the maintenance of strong relationships with funding partners, who demand credit-worthy investment products from First National.

In 2018 we will be challenged once again by a policy intervention; more specifically by the January 1st introduction of amendments to Guideline B-20 – Residential Mortgage Underwriting Practices and Procedures. Updated rules require conventional mortgage borrowers to qualify at interest rates higher than the actual rate offered by lenders. In this way, stress tests are now applied to both conventional and high-ratio borrowers. There is a significant degree of uncertainty about the ultimate impact of these latest rule changes. Our early assessment is that they will further reduce the size of our addressable market, lead to increased competition and have a dampening effect on single-family originations, but not renewals (which are unaffected by the B-20 updates). At the same time, we believe that strength in the economy may provide a counter-balancing effect.

Of course, we cannot accurately predict the future of our markets. What we can and will do is focus on the things we can control, most especially service.

A PEOPLE BUSINESS

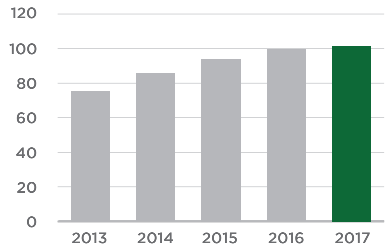
Although mortgage finance is complex and our products are financial in nature, First National is, at heart, a people business. We organized our company in the very beginning to put a premium on building customer relationships. Our view then, and now, is that we exist to provide solutions, not just a mortgage. In fact, we believe a product sale is important but secondary to providing the right advice for our customers.

We define the term customer to include borrowers and their advisors, funding partners and the large institutional base of investors. To First National, every one of these relationships is critical to our success. When mortgage brokers weigh our offerings against the competition and recommend us based on their professional assessment, we get the chance to serve a borrower. When a borrower is satisfied with our offering and values the service we provide, we earn a mortgage renewal and often the chance to provide funds for future transactions. When institutional investors evaluate our performance – including both profitability and our servicing levels – and find it to be of high quality, they make more capital available.

Providing solutions to customers means, in part, investing in the business with the goal of providing responsive service. Some of these investments are seated in our information technology. In recent years, the team has modernized, expanded and improved Merlin, our leading residential mortgage underwriting software for brokers. It has also built the foundation to launch Merlin mobile,

MORTGAGES UNDER ADMINISTRATION

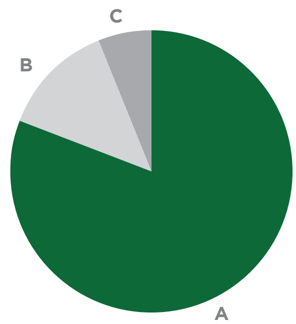
($ Billions)



2%

Year Over Year Growth 2016 to 2017

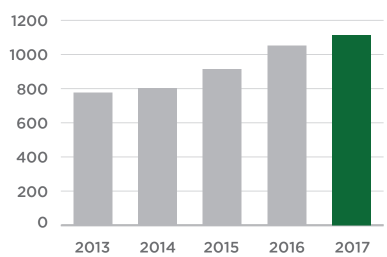
MUA BY ASSET TYPE



A 81% Insured
B 13% Conventional Single Family Residential
C 6% Multi-unit Residential and Commercial

REVENUE

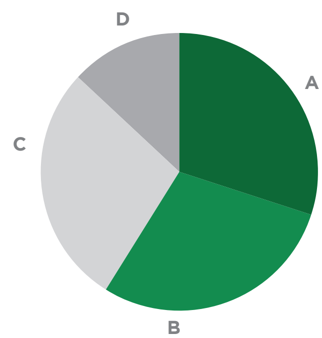
($ Millions)



3%

Year Over Year Growth in 2017

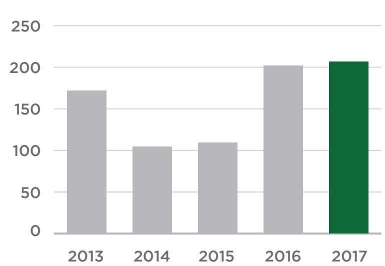
2017 REVENUE SOURCES PRIOR TO FAIR VALUE GAINS/LOSSES



A 30% Institutional Placements
B 29% Net Interest – Securitized Mortgages
C 28% Mortgage Servicing
D 13% Investment Income

NET INCOME

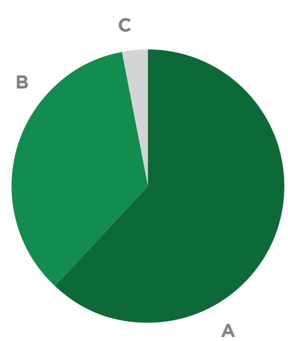
($ Millions)



4%

Year Over Year Growth in 2017

2017 FUNDING SOURCES



A 62% Institutional Investors
B 35% Securitization
C 3% Internal

an application that will allow brokers to access deals on their iOS and Android devices and has refreshed My Mortgage, our internet portal for residential customers. Over the past year, we also strengthened our replication capabilities to ensure the continuity of service in the event of unforeseen circumstances.

Beyond technology, we look to build our capacity as advisors and subject-matter experts. Given recent policy changes affecting residential mortgage markets, advice for mortgage brokers and borrowers is an increasingly important part of our value proposition. Advice is also key to our commercial market relationships. Commercial borrowers tell us they find value in First National's ability to act as a sounding board as they plan their land acquisition strategies, stress test their financial feasibility models, research CMHC and conventional financing alternatives and generally, help them run their businesses.

As a people business we must also invest in our most important asset: our employees. Recognizing that many members of our team are young and want career advancement opportunities, we provide in-class and online training, as well as mentoring. We conduct employee surveys every two years to benchmark satisfaction and shape our workforce programs. Reflecting our entrepreneurial culture, we are also open to new ideas and innovations aimed at improving our business. As a result, our retention rate is better than the industry average and our productivity levels are high. By breeding a professional, respectful work environment, we set the tone for how we engage with our customers.

WHAT LIES AHEAD

As we look forward to a new year, our 30th as a business, we face challenges but also opportunities. The challenges include the impact of new policy interventions mentioned above, as well as borrower and competitive reaction to revised rules. As explained in Management's Discussion and Analysis (MD&A), we will also feel the offsetting economic impact of 2017 gains on financial instruments in future earnings through tighter margins on new securitizations.

Opportunities will be created by an improving economy, mortgage renewals and the fact that despite its evident scale, First National provides financing for only about 5% of all single-family mortgages in Canada. Although we think of ourselves as Canada's largest commercial mortgage lender and a prolific originator, our own research suggests that some $40 billion of commercial mortgage transactions take place annually in our markets, implying our share is less than 15%. There is a long way for us to go and to grow.

There is also comfort in knowing that the company will continue to generate income and cash flow from its $27 billion portfolio of mortgages pledged under securitization and $74 billion servicing portfolio.

CREDIT WHERE IT'S DUE

Our recipe for success this year and over the past 30 years is not unique. What is unique is the disciplined way First National applies it in everything we do.

As I look back on the year and decades past, I am grateful for many things, but most especially the fact that I am surrounded by a resourceful team that cares deeply about growing safely and with integrity.

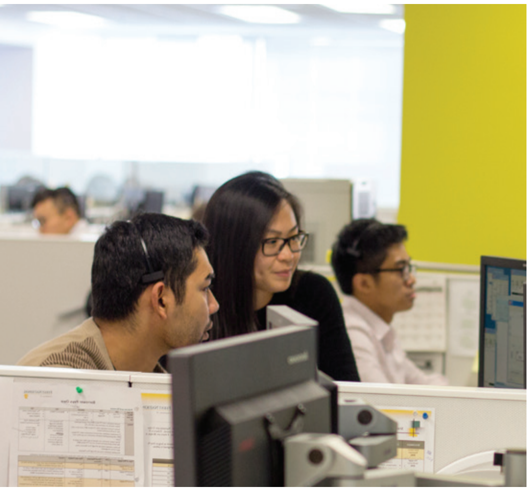
The team I'm referring to includes the members of our dedicated board who set the tone, First National's senior management group of talented, energetic leaders who set the agenda, and most important the people who serve throughout our organization delivering great results for customers, partners and shareholders, one mortgage at a time. Collectively, we are motivated in the right way and for the right reasons to succeed.

My sincere thanks goes to all stakeholders, internal and external, for making 2017 a memorable year and for creating the foundation from which we can achieve our ambitions in the future.

Yours sincerely,

Stephen Smith

Stephen Smith
Chairman and Chief Executive Officer



MANAGEMENT'S **DISCUSSION AND ANALYSIS**

The following management's discussion and analysis ("MD&A") of financial condition and results of operations is prepared as of February 27, 2018. This discussion should be read in conjunction with the audited consolidated financial statements and accompanying notes of First National Financial Corporation (the "Company" or "Corporation" or "First National") as at and for the year ended December 31, 2017. The audited consolidated financial statements of the Company have been prepared in accordance with International Financial Reporting Standards ("IFRS").

This MD&A contains forward-looking information. Please see "Forward-Looking Information" for a discussion of the risks, uncertainties and assumptions relating to these statements. The selected financial information and discussion below also refer to certain measures to assist in assessing financial performance. These other measures such as "Pre-FMV EBITDA" and "After-tax Pre-FMV Dividend Payout Ratio" should not be construed as alternatives to net income or loss or other comparable measures determined in accordance with IFRS as an indicator of performance or as a measure of liquidity and cash flow. These measures do not have standard meanings prescribed by IFRS and therefore may not be comparable to similar measures presented by other issuers.

Unless otherwise noted, tabular amounts are in thousands of Canadian dollars.

Additional information relating to the Company is available in First National Financial Corporation's profile on the System for Electronic Data Analysis and Retrieval ("SEDAR") website at www.sedar.com.

GENERAL DESCRIPTION OF THE COMPANY

First National Financial Corporation is the parent company of First National Financial LP ("FNFLP"), a Canadian-based originator, underwriter and servicer of predominantly prime residential (single-family and multi-unit) and commercial mortgages. With over $101 billion in mortgages under administration ("MUA"), First National is Canada's largest non-bank originator and underwriter of mortgages and is among the top three in market share in the mortgage broker distribution channel. The First National Mortgage Investment Fund (the "Fund") was terminated in December 2017 by the trustee and the Company purchased the mortgage portfolio at fair value from the Fund for approximately $23 million. While the Fund operated, the Company consolidated the Fund's results in its earnings because of its status as sole seller to the Fund and its rights as promoter. Accordingly, the results of the Fund until the date of termination were consolidated with those of the Company. From an accounting perspective, the purchase of the mortgage portfolio represents the redemption of the non-controlling interest related to the Fund recorded within shareholders' equity.

2017 RESULTS SUMMARY

Management is pleased with the results of 2017. Despite a decline in new single-family origination as a result of the new mortgage insurance rules announced in late 2016, overall origination including renewals increased by 2%. This was due to growth in the commercial segment and higher volumes of renewals. The Company's earnings benefited from large gains on account of financial instruments recorded largely in the second and third quarters of the year. While most of these gains will negatively impact the income in future periods, a portion relates to $770 million of mortgages originally funded for its own securitization program which the Company placed with institutional investors. Accordingly, about $14.4 million of the gains offset lower placement fees and the Company believes these gains should be added back to 2017 Pre-FMV earnings to properly account for them in operations.

- MUA grew to $101.6 billion at December 31, 2017 from $99.4 billion at December 31, 2016, an increase of 2%; the growth from September 30, 2017, when MUA was $100.2 billion, represented an annualized increase of 6%. The annual increase was just 2% because of lower new origination which declined 2% year over year. Lower MUA is also the result of the maturity of several CMBS transactions originally included in MUA in 2007. Because of scheduled maturities in this portfolio, CMBS MUA in the commercial segment is down by over $1.0 billion since the 2016 year end;

- Total new single-family mortgage origination was $11.1 billion in 2017 compared to $12.4 billion in 2016, a decrease of 10%. The Company believes this is a result of several regulatory changes including the new mortgage insurance rules announced in October 2016, increases in the cost of portfolio insurance and regional measures such as the foreign buyer tax in southern Ontario. The entire insured mortgage market shrank across the country and First National was affected to some extent in all regions. The commercial segment continued to grow with origination up 20% as volumes increased to $5.8 billion in 2017 from $4.8 billion in 2016. The Company attributes this positive performance to its expanded presence in the conventional market. Overall new origination decreased by 2%;
- The Company took advantage of opportunities in the year to renew $5.2 billion of single-family mortgages. In 2016, the Company renewed $4.6 billion of single-family mortgages. For the commercial segment, renewals increased to $1.1 billion from $1.0 billion;
- Revenue for 2017 increased to $1.1 billion from $1.0 billion in 2016. The increase is the result of a rising interest rate environment which affected interest revenue earned on securitized mortgages, mortgage investment income, gains on financial instruments and mortgage servicing revenue. These increases offset placements fees which were lower as the Company increased the amount of mortgages it used for securitization;
- Income before income taxes increased from $274.1 million in 2016 to $285.4 million in 2017. This measure increased largely because of changing capital markets conditions, which affected the Company's economic interest rate hedges. In 2017, the Company recorded an additional $28.5 million of gains on financial instruments compared to 2016; and
- The Company's earnings before income taxes, depreciation and amortization and gains and losses on financial instruments ("Pre-FMV EBITDA") for the year decreased by 8%, from $253.5 million in 2016 to $234.3 million in 2017. The decrease was the result of lower placement fees revenue negatively affected by capital market conditions. The Company calculates that placement fees were $14.4 million less than they would have been in a static interest rate environment. Because these transactions were economically hedged, the lower fees are effectively offset by a $14.4 million portion of the gains on financial instruments recorded in 2017. Adjusting for this item, 2017 Pre-FMV EBITDA was lower by 2% year over year because of tighter mortgage spreads and higher broker fees.

SELECTED QUARTERLY INFORMATION

Quarterly Results of First National Financial Corporation
($000s, except per share amounts)

	Revenue	Net Income for the period	Pre-FMV EBITDA for the period (1)	Net Income per Common Share	Total Assets
2017					
Fourth Quarter	**$270,015**	**$45,948**	**$61,093**	**$0.75**	**$32,776,278**
Third Quarter	**284,315**	**58,809**	**51,826**	**0.96**	**31,548,130**
Second Quarter	**292,200**	**68,768**	**68,275**	**1.13**	**30,832,883**
First Quarter	**232,238**	**36,127**	**53,084**	**0.58**	**29,901,289**
2016					
Fourth Quarter	$290,754	$71,797	$61,064	$1.18	$30,394,465
Third Quarter	273,754	51,440	67,469	0.84	30,527,361
Second Quarter	253,915	41,251	68,187	0.67	31,011,683
First Quarter	231,395	37,341	56,819	0.59	28,194,301

(1) This non-IFRS measure adjusts income before income taxes by adding back expenses for amortization of intangible and capital assets but it also eliminates the impact of changes in fair value by adding back losses on the valuation of financial instruments and deducting gains on the valuation of financial instruments.

With First National's large portfolio of mortgages pledged under securitization, quarterly revenue is driven primarily by the gross interest earned on the mortgages pledged under securitization. The gross interest on the mortgage portfolio is dependent both on the size of the portfolio of mortgages pledged under securitization as well as weighted average mortgage rates. Although mortgage rates have not changed significantly in the last two years, the Company has generally increased MUA and its portfolio of securitized mortgages over the last 24 months. Net income is partially dependent on conditions in the debt markets, which affect the value of gains and losses on financial instruments arising from the Company's interest rate hedging program. Accordingly, the movement of this measurement between quarters is related to factors external to the Company's core business (primarily conditions in the bond markets). By removing this volatility and analyzing Pre-FMV EBITDA, management believes a more appropriate measurement of the Company's performance can be assessed.

Generally, in the years prior to 2017, the Company grew its origination volumes which provided larger servicing and securitization portfolios. This longer-term strategy has been successful and Pre-FMV EBITDA has trended upwards. The table above shows a trend of growing income reflecting typical Canadian seasonality: slower first and fourth quarters and stronger mid-year quarters. The first and fourth quarters of 2017 and the first quarter of 2016 did not have significant fair value gains or losses and are more consistent with normalized earnings for the Company. The fourth quarter of 2016 and second and third quarters of 2017 featured large fair values gains as bond prices decreased as a result of positive economic expectations. This had a large impact on net income. By excluding fair value gains and losses, Pre-FMV EBITDA provides a more comparable performance metric. For third quarter 2017, Pre-FMV EBITDA decreased compared to the third quarter of 2016 as placement fees were negatively affected by a rising interest rate environment. By adjusting this measure and adding the $14.4 million which was primarily recorded as a gain on holding short bonds in the second quarter 2017, the amount is more consistent with the Pre-FMV EBITDA recorded in third quarter 2016. Generally, earnings are marginally lower in 2017 due to lower single-family origination and tighter mortgage spreads.

OUTSTANDING SECURITIES OF THE CORPORATION

At December 31, 2017 and February 27, 2018, the Corporation had 59,967,429 common shares; 2,887,147 Class A preference shares, Series 1; 1,112,853 Class A preference shares, Series 2; and 175,000 April 2020 notes outstanding.

	2017	2016	2015
For the Year ended December 31, Income Statement Highlights			
Revenue	**$1,078,768**	$1,049,818	$915,315
Interest expense – securitized mortgages	**(511,939)**	(495,681)	(488,659)
Brokerage fees	**(83,260)**	(103,719)	(107,045)
Salaries, interest and other operating expenses	**(193,032)**	(169,129)	(161,821)
Add (deduct): realized and unrealized (gains) losses on financial instruments	**(56,259)**	(27,750)	52,143
Pre-FMV EBITDA(1)	**234,278**	253,539	209,933
Amortization of capital assets	**(5,135)**	(4,660)	(4,114)
Amortization of intangible assets	**—**	(2,500)	(5,000)
Add (deduct): realized and unrealized gains (losses) on financial instruments	**56,259**	27,750	(52,143)
Provision for income taxes	**(75,750)**	(72,300)	(39,245)
Net income	**209,652**	201,829	109,431
Common share dividends declared	**184,400**	98,946	90,451
Per Share Highlights			
Net income per common share	**3.42**	3.28	1.71
Dividends per common share	**3.08**	1.65	1.51
At Year End **Balance Sheet Highlights** **Total assets**	**$32,776,278**	$30,394,465	$27,926,732
Total long-term financial liabilities	**$174,693**	$174,556	$174,420

(1) Pre-FMV EBITDA is not a recognized earnings measure under IFRS and does not have a standardized meaning prescribed by IFRS. Therefore, Pre-FMV EBITDA may not be comparable to similar measures presented by other issuers. Investors are cautioned that Pre-FMV EBITDA should not be construed as an alternative to net income or loss determined in accordance with IFRS as an indicator of the Company's performance or as an alternative to cash flows from operating, investing and financing activities as a measure of liquidity and cash flows.

VISION AND STRATEGY

The Company provides mortgage financing solutions to the residential and commercial mortgage markets in Canada. By offering a full range of mortgage products, with a focus on customer service and superior technology, the Company believes that it is the leading non-bank mortgage lender in the industry. The Company intends to continue leveraging these strengths to lead the "non-bank" mortgage lending industry in Canada, while appropriately managing risk. The Company's strategy is built on four cornerstones: providing a full range of mortgage solutions for Canadian single-family and commercial customers; growing assets under administration; employing technology to enhance service to mortgage brokers and borrowers, lower costs and rationalize business processes; and maintaining a conservative risk profile. An important element of the Company's strategy is its direct relationship with the mortgage borrower. The Company is considered by most of its borrowers as the mortgage lender. This is a critical distinction. It allows the Company to communicate with each borrower directly throughout the term of the related mortgage. Through this relationship, the Company can negotiate new transactions and pursue marketing initiatives. Management believes this strategy will provide long-term profitability and sustainable brand recognition for the Company.

KEY PERFORMANCE DRIVERS

The Company's success is driven by the following factors:

- Growth in the portfolio of mortgages under administration;
- Growth in the origination of mortgages;
- Raising capital for operations; and
- Employing innovative securitization transactions to minimize funding costs.

GROWTH IN PORTFOLIO OF MORTGAGES UNDER ADMINISTRATION

Management considers the growth in MUA to be a key element of the Company's performance. The portfolio grows in two ways: through mortgages originated by the Company and through third-party mortgage servicing contracts. Mortgage originations not only drive revenues from placement and interest from securitized mortgages, but perhaps more importantly, longer-term value from servicing fees, mortgage administration fees, renewals and the growth of the customer base for marketing initiatives. As at December 31, 2017, MUA totalled $101.6 billion, up from $99.4 billion at December 31, 2016, an increase of 2%. This compares to $100.2 billion at September 30, 2017, representing an annualized increase of 6%. Despite the maturity of over $1.0 billion of CMBS mortgages in 2017 which had been in MUA since 2007, the Company was still able to grow MUA.

GROWTH IN ORIGINATION OF MORTGAGES

Direct origination by the Company

The origination of mortgages not only drives the growth of MUA as described above, but leverages the Company's origination platform, which has a large fixed-cost component. As more mortgages are originated, the marginal costs of underwriting decrease. By growing origination, not only can the Company satisfy demand from its institutional customers, but it can also produce volume for its own securitization programs. In 2017, the Company felt the impact of the new mortgage insurance rules enacted in October 2016. Generally, these rules had the effect of shrinking the availability of insured mortgages particularly because of the limitations on insurance for refinance transactions and the more onerous qualification rules. For the Company, this meant lower origination across the country with decreases from volumes recorded by the following offices in 2016: Vancouver (18%), Calgary (15%) and Montreal (27%). The Toronto office had better results and had slightly higher volume than in 2016. In total, the Company's single-family origination decreased in 2017 by 10%. The commercial segment continued to show strong growth as volume increased 20% over 2016. Together, overall new origination for 2017 decreased by 2% year over year.

Third Party Mortgage Underwriting and Fulfillment Processing Services

In 2015, the Company launched its third party underwriting and fulfillment processing services business with a large Canadian schedule I bank ("Bank"). The business is designed to adjudicate mortgages originated by the Bank through the single-family residential mortgage broker channel. First National employs a customized software solution based on its industry leading MERLIN technology to accept mortgage applications from the Bank in the mortgage broker channel and underwrite these mortgages in accordance with the Bank's underwriting guidelines. The Bank funds all the mortgages underwritten under the agreement and retains full responsibility for mortgage servicing and the client relationship. Management considers the agreement a way to leverage the capabilities and strengths of First National in the mortgage broker channel and add some diversity to the Company's service offerings.

RAISING CAPITAL FOR OPERATIONS

Bank Credit Facility

The Company uses a $1.06 billion revolving line of credit with a syndicate of banks. This facility enables the Company to fund the large amounts of mortgages accumulated for securitization. In the first quarter of 2017, the Company extended the term of the facility by almost two years such that the new maturity is in March 2022. In the 2017 third quarter, the Company added another bank lender to the syndicate, increasing the commitment under the facility by $60 million. The facility bears interest at floating rates. The Company has elected to undertake this debt for a number of reasons: (1) the facility provides the amount of debt required to fund mortgages originated for securitization purposes; (2) the debt is revolving and can be used and repaid as the Company requires, providing more flexibility than the senior unsecured notes, which are fully drawn during their term; (3) the five-year remaining term gives the Company a committed facility for the medium term; and (4) the cost of borrowing reflects the Company's BBB issuer rating.

Preferred Share Issuance

On February 24, 2016, the Company announced that it would not exercise its right to redeem the 4,000,000 Class A Series 1 preference shares issued in 2011. It also advised shareholders of their rights under the shares which allow for a one-for-one conversion from Series 1 shares which have a fixed rate dividend into Series 2 shares which have a floating rate dividend. Pursuant to these rights, a portion of Series 1 shareholders elected to convert 1,112,853 of the Series 1 shares into Series 2 shares. Accordingly, effective April 1, 2016, 1,112,853 Series 1 shares converted to Series 2 shares leaving 2,887,147 Series 1 shares outstanding. The Series 1 shares will continue to trade as FN.PR.A on the TSX, while the Series 2 shares began trading as FN.PR.B on April 1, 2016. The Series 1 shares provide an annual dividend rate of 2.79% effective April 1, 2016. Both the Series 1 and Series 2 shares pay quarterly dividends, subject to Board of Director approval and are redeemable at the discretion of the Company such that after the five-year term ending on March 31, 2021, the Company can choose to extend the shares for another five-year term at a fixed spread (2.07%) over the relevant index (five-year Government of Canada bond yield for any Series 1 shares or the 90-day T-Bill rate for any Series 2 shares). While the investors in these shares have an option on each five-year anniversary to convert their Series 1 preference shares into Series 2 preference shares (or vice versa), there is no provision of redemption rights to these shareholders. As such, the Company considers these shares to represent a permanent source of capital and classifies the shares as equity on its balance sheet. Management believes this capital has provided the Company with the opportunity to pursue its strategy of increased securitization, which requires upfront investment.

EMPLOYING SECURITIZATION TRANSACTIONS TO MINIMIZE FUNDING COSTS

Approval as both an Issuer of NHA-MBS and Seller to the Canada Mortgage Bonds Program

The Company has been involved in the issuance of NHA-MBS as an administrator since 1995. In December 2007, the Company was approved by Canada Mortgage and Housing Corporation ("CMHC") as an issuer of NHA-MBS and as a seller into the CMB program. Issuer status has provided the Company with direct and independent access to reliable and low-cost funding.

Mortgage spreads can be illustrated by comparing posted five-year fixed single-family mortgage rates to a similar-term Government of Canada bond as listed in the table below.

Period	Average Five Year Mortgage Spread for the Period
2006	1.12%
2007	1.50%
2008	2.68%
2009 - 2013	1.79%
2014	1.57%
2015	1.87%
2016	1.76%
2017	1.36%

The table shows an average spread of 1.12% in 2006. With the credit crisis, this spread ballooned to as high as 3.46% in 2008. Between 2009 and 2013, liquidity issues at financial institutions diminished and the competition for mortgages increased such that spreads remained consistently higher than pre-crisis levels. In 2014, more competitive pressures took mortgage rates lower and compressed mortgage spreads to 2007 levels. In 2015, mortgage spreads quickly widened as a slowdown in economic growth and the Bank of Canada rate cut reduced bond yields dramatically. This trend continued into 2016, as optimism about the economy was mixed such that spreads remained at levels in excess of 1.8% until the third quarter when increased competition made for tighter spreads.

With the recent strength in the economy and tougher mortgage rules, competition has further increased and spreads tightened significantly. While funding spreads have also improved, generally the advantage of securitization compared to placement with investors is not as distinct as it was in the previous 10-year period. In 2017, the Company originated and renewed for securitization purposes approximately $7.1 billion of single-family mortgages and $1.1 billion of multi-unit residential mortgages. In the year, the Company securitized through NHA-MBS approximately $5.7 billion of single-family mortgages and $0.7 billion of multi-unit residential mortgages.

In August 2013, CMHC announced that it would be limiting the amount of guarantees it would provide on NHA-MBS pools created for sale to the "market". CMHC indicated that the amount of guarantees it was providing for such market pools (generally any pool not sold to the Canada Housing Trust ("CHT") for the CMB) was growing significantly. To better control the absolute amount of risk that it takes on in this respect, CMHC has implemented policies to allocate the amount of guarantees to issuers. The maximum amount allocated under the process has exceeded First National's requirements in every quarter since inception. The process was amended in July 2016 to combine both NHA MBS for sale to the market and to CHT under one allocation. The available guarantees to be allocated were increased to accommodate issuance to CHT and continue to exceed the Company's current needs.

Canada Mortgage Bonds Program

The CMB program is an initiative sponsored by CMHC whereby the CHT issues securities to investors in the form of semi-annual interest-yielding five- and 10-year bonds. Pursuant to the Company's approval as a seller into the CMB, the Company is able to make direct sales into the program. The ability to sell into the CMB has given the Company access to lower costs of funds on both single-family and multi-family mortgage securitizations. Because of the effectiveness of the CMB, many institutions have indicated their desire to participate. As a result, CHT has created guidelines through CMHC that limit the amount that can be sold by each seller into the CMB each quarter. The Company is subject to these limitations. Beginning in July 2016, CHT effectively increased the price of the timely payment guarantees which CMB participants are required to purchase with the issuance of each CMB transaction. Although nominally CMB fees were decreased, these rules require guarantee fees to be levied on the creation of NHA MBS pools being sold to the CMB. Prior to this rule change, the NHA MBS pools to be sold into the CMB were exempt from such fees. In aggregate, guarantee fees have increased between 25% and 50% for CMB participants. This increase translates to approximately five basis points of cost over the term of the securitization. At the same time, CMHC has also modified the tiered NHA MBS guarantee fee pricing structure, increasing the issuance threshold for increased fees from $6.0 billion to $7.5 billion.

In 2017, the Company was approved by CMHC as a "small repo counterparty" for the CMB program. Essentially this allows the Company more flexibility when investing the cash held in trust by CHT and may increase the yield the Company receives when it reinvests funds in replacement accounts associated with its CMB transactions. Also in 2017, a subsidiary of First National, First National Asset Management Inc. was given conditional approval by CMHC to become an "aggregator" for CMB purposes. An aggregator has the ability to sell into the CMB with the caveat that it must share the CMB allocation with its parent and typically purchases mortgages from arms-length originators. The Company believes this approval will allow it to leverage on the expertise it has gained over the past 10 years as a CMB participant. With the current environment of narrow mortgage interest spreads, the Company does not foresee using this vehicle to any significant extent in 2018. As the marketplace adjusts in the longer term, the value of this vehicle may increase.

KEY PERFORMANCE INDICATORS

The principal indicators used to measure the Company's performance are:

- Earnings before income taxes, depreciation and amortization, and losses and gains on financial instruments ("Pre-FMV EBITDA"[1]); and
- Dividend payout ratio.

Pre-FMV EBITDA is not a recognized measure under IFRS. However, management believes that Pre-FMV EBITDA is a useful measure that provides investors with an indication of income normalized for capital market fluctuations. Pre-FMV EBITDA should not be construed as an alternative to net income determined in accordance with IFRS or to cash flows from operating, investing and financing activities. The Company's method of calculating Pre-FMV EBITDA may differ from other issuers and, accordingly, Pre-FMV EBITDA may not be comparable to measures used by other issuers.

	QUARTER ENDED		YEAR ENDED	
($000s)	December 31, 2017	December 31, 2016	December 31, 2017	December 31, 2016
FOR THE PERIOD				
Revenue	**$270,015**	$290,754	**$1,078,768**	$1,049,818
Income before income taxes	**63,158**	97,697	**285,402**	274,129
Pre-FMV EBITDA[1]	**61,093**	61,064	**234,278**	253,539
AT PERIOD END				
Total assets	**$32,776,278**	$30,394,465	**$32,776,278**	$30,394,465
Mortgages under administration	**$101,589,153**	$99,391,490	**$101,589,153**	$99,391,490

Note:
[1] This non-IFRS measure adjusts income before income taxes by adding back expenses for amortization of intangible and capital assets, but it also eliminates the impact of changes in fair value by adding back losses on the valuation of financial instruments and deducting gains on the valuation of financial instruments.

Since going public in 2006, First National has been considered a high-yielding dividend paying company. Over this period, the Company has paid almost $1.1 billion of dividends/distributions to common shareholders/unitholders. With a large MUA which generates continuing income and cash flow and a business model which is designed to make efficient use of capital, the Company has been able to pay distributions to its shareholders which represent a relatively large ratio of its earnings. The Company calculates the dividend payout ratio as dividends declared on common shares over net income attributable to common shareholders. This measure is useful to shareholders as it indicates the percentage of earnings which have been paid out in dividends. Similar to the performance measure for earnings, the Company also calculates the dividend payout ratio on a basis using after-tax Pre-FMV EBITDA.

	QUARTER ENDED		YEAR ENDED	
($000s)	December 31, 2017	December 31, 2016	December 31, 2017	December 31, 2016
FOR THE PERIOD				
Net income attributable to common shareholders	**$44,972**	$70,639	**$205,331**	$196,531
Total dividends paid or declared on common shares	**102,694**	25,486	**184,400**	98,946
Dividends paid or declared on common shares, excluding special dividend	**27,735**	25,486	**109,441**	98,946
Total Common Share Dividend Payout Ratio	**228%**	36%	**90%**	50%
Regular Common Share Dividend Payout Ratio [1]	**62%**	36%	**53%**	50%
After-tax Pre-FMV Dividend Payout Ratio [2]	**65%**	60%	**67%**	56%

Note:
(1) This ratio is calculated by excluding the payment of the special dividend declared in November 2017.
(2) This non-IFRS measure adjusts the net income used in the calculation of the dividend payout ratio to after tax Pre-FMV earnings so as to eliminate the impact of changes in fair value by adding back losses on the valuation of financial instruments and deducting gains on the valuation of financial instruments. The Company uses its aggregate effective tax rate to tax affect the impact of the valuation of financial instruments on this ratio. For 2017 this ratio excludes the special dividend declared in November 2017.

For the year ended December 31, 2017, the common share payout ratio was 90% compared to 50% in 2016. However, in November 2017, the Company declared a special dividend which represented the distribution of excess retained earnings generated over the past several years. This distorts the payout ratio calculated in 2017. If the special dividend is excluded from the calculation, the payout ratio in 2017 would have been 53%. In 2017, the Company recorded large gains on account of the changes in fair value of financial instruments. The gains are recorded in the period in which the prices on Government of Canada bond yields change; however, the offsetting economic impact is largely to be reflected in narrower spreads in the future from the mortgages pledged for securitization. Accordingly, management does not consider this revenue to be available for dividend payment. If the gains on financial instruments in the two years are excluded from the above calculations, the dividend payout ratio for 2017 would have been 67% compared to 56% in 2016.

The Company also paid $2.7 million of dividends on its preferred shares in 2017 compared to $3.2 million in 2016.

REVENUES AND FUNDING SOURCES

Mortgage Origination

The Company derives a significant amount of its revenue from mortgage origination activities. Most mortgages originated are funded either by placement with institutional investors or through securitization conduits, in each case with retained servicing. Depending upon market conditions, either an institutional placement or a securitization conduit may be the most cost-effective means for the Company to fund individual mortgages. In general, originations are allocated from one funding source to another depending on market conditions and strategic considerations related to maintaining diversified funding sources. The Company retains servicing rights on virtually all of the mortgages it originates, which provide the Company with servicing fees to complement revenue earned through originations. For the year ended December 31, 2017, new origination volume decreased from $17.2 billion to $16.9 billion, or about 2%, compared to 2016.

Securitization

The Company securitizes a portion of its origination through various vehicles, including NHA-MBS, CMB and Asset-backed Commercial Paper ("ABCP"). Although legally these transactions represent sales of mortgages, for accounting purposes they do not meet the requirements for sale recognition and instead are accounted for as secured financings. These mortgages remain as mortgage assets of the Company for the full term and are funded with securitization-related debt. Of the Company's $23.2 billion of new originations and renewals for the year ended December 31, 2017, $8.2 billion was originated for its own securitization programs.

Placement Fees and Gain on Deferred Placement Fees

The Company recognizes revenue at the time that a mortgage is placed with an institutional investor. Cash amounts received in excess of the mortgage principal at the time of placement are recognized in revenue as "placement fees". The present value of additional amounts expected to be received over the remaining life of the mortgage sold (excluding normal market-based servicing fees) is recorded as a "deferred placement fee". A deferred placement fee arises when mortgages with spreads in excess of a base spread are sold. Normally the Company would earn an upfront cash placement fee, but investors prefer paying the Company over time as they earn net interest margin on such transactions. Upon the recognition of a deferred placement fee, the Company establishes a "deferred placement fee receivable" that is amortized as the fees are received by the Company. Of the Company's $23.2 billion of new originations and renewals in 2017, $14.3 billion was placed with institutional investors.

For all institutional placements and mortgages sold to institutional investors for the NHA-MBS market, the Company earns placement fees. Revenues based on these originations are equal to either (1) the present value of the excess spread, or (2) an origination fee based on the outstanding principal amount of the mortgage. This revenue is received in cash at the time of placement. In addition, under certain circumstances, additional revenue from institutional placements and NHA-MBS may be recognized as "gain on deferred placement fees" as described above.

Mortgage Servicing and Administration

The Company services virtually all mortgages generated through its mortgage origination activities on behalf of a wide range of institutional investors. Mortgage servicing and administration is a key component of the Company's overall business strategy and a significant source of continuing income and cash flow. In addition to pure servicing revenues, fees related to mortgage administration are earned by the Company throughout the mortgage term. Another aspect of servicing is the administration of funds held in trust, including borrowers' property tax escrows, reserve escrows and mortgage payments. As acknowledged in the Company's agreements, any interest earned on these funds accrues to the Company as partial compensation for administration services provided. The Company has negotiated favourable interest rates on these funds with the chartered banks that maintain the deposit accounts, which has resulted in significant additional servicing revenue.

In addition to the interest income earned on securitized mortgages and deferred placement fees receivable, the Company also earns interest income on mortgage-related assets, including mortgages accumulated for sale or securitization, mortgage and loan investments and purchased mortgage servicing rights.

The Company provides underwriting and fulfilment processing services to a mortgage originator using the mortgage broker distribution channel. The Company earns a fee based on the dollar value of funded mortgages. These fees are recognized at the time a mortgage funds and is included in "Mortgage servicing income" in the consolidated statement of comprehensive income.

RESULTS OF OPERATIONS

The following table shows the volume of mortgages originated by First National and mortgages under administration for the periods indicated:

	QUARTER ENDED		YEAR ENDED	
($ millions)	December 31, 2017	December 31, 2016	December 31, 2017	December 31, 2016
MORTGAGE ORIGINATIONS BY SEGMENT				
New single-family residential	**$2,787**	$2,700	**$11,133**	$12,424
New multi-unit and commercial	**1,645**	1,398	**5,770**	4,811
Sub-total	**4,432**	4,098	**16,903**	17,235
Single-family residential renewals	**1,124**	1,058	**5,219**	4,553
Multi-unit and commercial renewals	**257**	349	**1,127**	974
Total origination and renewals	**$5,813**	$5,505	**$23,249**	$22,762
MORTGAGE ORIGINATIONS BY FUNDING SOURCE				
Institutional investors – new residential	**$1,254**	$1,707	**$6,240**	$7,701
Institutional investors – renew residential	**564**	656	**2,688**	2,148
Institutional investors – multi/commercial	**1,271**	1,469	**5,342**	4,717
NHA-MBS/CMB/ABCP securitization	**2,449**	1,580	**8,199**	7,682
Internal Company resources /CMBS	**275**	93	**780**	514
Total	**$5,813**	$5,505	**$23,249**	$22,762
MORTGAGES UNDER ADMINISTRATION				
Single-family residential	**$77,423**	$77,152	**$77,423**	$77,152
Multi-unit residential and commercial	**24,166**	22,239	**24,166**	22,239
Total	**$101,589**	$99,391	**$101,589**	$99,391

Total new mortgage origination volumes decreased in 2017 compared to 2016 by 2%. Single-family volumes decreased by 10% and commercial segment volumes increased by 20% year over year. The decrease in the single-family segment is evident across the country as the Company's Vancouver, Calgary and Montreal offices reported an average decrease of about 19% over 2016 volumes. In Ontario and the Maritimes, the Company's volume was marginally higher than the volume recorded in 2016. When combined with renewals, total production increased from $22.8 billion in 2016 to $23.2 billion in 2017, or by 2%. The Company believes lower new single-family origination is the result of the new mortgage insurance rules which have reduced the amount of insured mortgages available in the overall market. In the fourth quarter of 2017, the Company's single-family origination grew by 3%. Management believes this may be the result of new B-20 mortgage qualifying rules announced in 2017 which are effective beginning in 2018. Generally, these rules reduce the amount of mortgage a borrower can take on and so has encouraged buyers to accelerate their purchase of real estate into 2017. The low interest rate environment together with the Company's expertise in mortgage underwriting drove higher commercial segment origination volumes. Origination for direct securitization into NHA-MBS, CMB and ABCP programs remained a large part of the Company's strategy with volume of $8.2 billion in 2017. The Company used such securitization funding to a greater degree than institutional placements in 2016. Generally, the Company maintained a balance between these funding sources despite the reduction in profitability of securitization in a tight spread environment. The Company's long-term strategy has always been to maintain diverse funding sources.

Net Interest - Securitized Mortgages

Comparing the year ended December 31, 2017 to the year ended December 31, 2016, "net interest – securitized mortgages" increased by 2% to $146.8 million from $144.3 million. The increase is due to growth in the Company's securitization programs and the rising interest rate environment. The portfolio of securitized mortgages grew to $27.6 billion by the end of 2017 or about 5%. Interest expense – securitized mortgages is affected by the cost of indemnities payable to debtholders when mortgages prepay prior to their scheduled maturity date. The indemnities are calculated to make whole debtholders who are assumed to reinvest the prepayment principal at risk free reinvestment rates. With the recent increase in interest rates, the cost of such indemnity has decreased significantly. The Company calculates that because of the decrease in indemnity costs, that it has earned an additional $8.4 million in net interest margin. This increase has been offset by the effect of the Company's hedging program. As gains and losses are recorded in the period in which bond prices change, the offsetting economic impact is reflected in wider or narrower spreads on the mortgages pledged for securitization and are realized in net interest margin over the terms of the mortgages.

In 2014 and 2015, the Company recorded large losses on financial instruments totaling $87 million. This implies that wider securitization spreads than anticipated will be earned as the related mortgages are securitized. The Company estimates that in 2017, net interest – securitized mortgages benefited from this timing issue by an amount of approximately $12.2 million. This trend reversed in 2016 when large gains related to short bonds were realized in the fourth quarter of 2016 and the second and third quarters of 2017. To the extent these gains pertained to securitized mortgages, the offset will be narrower securitization spreads earned on future securitizations. The Company estimates that in 2017, there was perhaps a slight loss in interest – securitized mortgages from the aggregate impact of all previous gains and losses. Accordingly, the accounting treatment of gains and losses on hedging activity suggest a $12.4 million decrease in this item. The amortization of deferred origination and other costs that are capitalized on securitized mortgages also have an effect on net interest. The Company has recently securitized more single-family renewals which do not have such costs and create wider spreads which positively impacted this quarter's net interest margin.

Placement Fees

Placement fee revenue decreased by 18% to $144.6 million from $176.9 million in 2016. The decrease is explained largely by new residential origination volume for institutional customers, excluding renewals, which decreased from $7.7 billion in 2016 to $6.2 billion in 2017 or by 19%. Placement fees per unit were lower due to the interest rate environment. With interest rates rising steadily over the past year, the value of mortgages held for securitization decreased during the holding period between origination and placement. Accordingly, when these mortgages were sold to institutional investors in the third quarter of 2017, the per unit fee was lower than in an otherwise static interest rate period. However, the Company economically hedged the exposure to such movements in interest rates, and the benefit of these contracts is recorded in "realized and unrealized gains (losses) on financial instruments." Management believes that the two transactions should be regarded together in order to determine the financial result of its decision making. In the third quarter, the Company calculated that approximately $10.9 million of revenue recorded as gains on financial instruments economically pertain to residential placement transactions recorded in the 2017 third quarter. For the commercial segment, this amount was $3.5 million. By adding the aggregate of $14.4 million, placement fee revenue for 2017 becomes $159.0 million or just 10% lower than in 2016. While the same issues existed throughout the year, only the impact in the third quarter was significant. Although single-family renewals increased, the additional origination was securitized by the Company and placement fees did not benefit materially from the increased volume. The commercial segment had significant origination growth in the quarter, but revenue in placement fees increased by just 10% as the Company originated more for its own securitization programs and spreads were tighter in a more competitive market.

Gains on Deferred Placement Fees

Gains on deferred placement fees revenue decreased 39% to $10.0 million from $16.3 million. The gains relate to multi-unit residential mortgages originated and sold to institutional NHA-MBS issuers. Although volumes for these transactions decreased by just 10% from 2016, spreads on these transactions tightened such that the Company realized lower per unit gains.

Mortgage Servicing Income

Mortgage servicing income increased 7% to $140.8 million from $131.4 million. This increase was due to revenue earned on the underwriting and fulfillment processing services business which the Company launched in January 2015 and has successfully grown since then. Without this revenue, mortgage servicing income grew in line with the MUA growth.

Mortgage Investment Income

Mortgage investment income increased 19% to $68.3 million from $57.5 million. The increase is due largely to an increase in the Company's commercial bridge loan program offset by an increased loan loss provision. The commercial bridge loan portfolio grew by about $130 million from December 2016 to December 2017 providing more investment income. The Company provided for losses of another $4.0 million (2016 - $3.5 million) regarding four non-performing properties in the commercial bridge portfolio in 2017. In addition, the interest rates associated with the Company's mortgages warehoused prior to securitization were higher this year such that more interest income is earned during the warehousing period than in 2016.

Realized and Unrealized Gains (Losses) on Financial Instruments

For First National, this financial statement line item typically consists of two components: (1) gains and losses related to the Company's economic hedging activities, and (2) gains and losses related to holding term assets derived using discounted cash flow methodology. Much like the short bonds that the Company uses for hedging, the term assets are affected by changes in credit markets and Government of Canada bond yields (which form the risk-free benchmarks used to estimate the fair value of the Company's deferred placement fees receivable and mortgages designated as held for trading). The following table summarizes these gains and losses by category in the periods indicated:

As 2016 began, economic sentiment was uncertain and 5-year bond prices increased which meant generally the Company recorded losses on its hedging program. In the fourth quarter of 2016, with the promise of increased economic stimulus from the election of the Republican candidate in the United States, the bond market moved dramatically and bond prices decreased significantly. While this momentum subsided in the first quarter of 2017, with economic optimism in the second quarter bond prices decreased significantly again such that First National's short bond position, which is used to economically hedge mortgages, experienced a large increase in value through to the end of the year. The bond markets were relatively flat until the last few weeks of June 2017, when economic data turned more positive and there were signs that the Bank of Canada might increase short term interest rates shortly. This caused bond yields to increase and 5-year bond prices to decrease. This occurred again in September 2017 with another increase in the overnight rate by the Bank of Canada. The consequences for the Company were large gains on the Company's short bond position.

The Company uses short Government of Canada bonds (including CHT-issued bonds) together with repurchase agreements, to create synthetic forward interest rate contracts to hedge the interest rate risk associated with fixed-rate mortgages originated for its own securitization programs. For accounting purposes, these do not qualify as interest rate hedges as the bonds used are not derivatives but cash-based financial instruments. These gains or losses are recorded in the period in which the bond prices change; however, the offsetting economic gains or losses are generally not recorded in the same period. Instead, the resulting economic gain (or loss) is usually reflected in wider or narrower spreads on the mortgages pledged for securitization and will be realized in net interest margin over the terms of the mortgages and the related debts. On occasion, the Company will place

Summary of realized and unrealized gains (losses) on financial instruments	**QUARTER ENDED**		**YEAR ENDED**	
($000s)	December 31, 2017	December 31, 2016	December 31, 2017	December 31, 2016
Gains on short bonds used for the economic hedging program	**$1,383**	$27,371	**$35,467**	$10,897
Losses on mortgages held at fair value	**(7,171)**	(14,900)	**(25,311)**	(4,597)
Gains on interest rate swaps	**9,276**	26,064	**47,133**	21,915
Other gains (losses)	**137**	(667)	**(1,030)**	(465)
Total gains on financial instruments	**$3,625**	$37,868	**$56,259**	$27,750

mortgages initially originated for securitization with institutional customers. In these cases, the economic value of any gains or losses on account of financial instruments will be offset in the same period as the placement fee to the institution is determined, with reference to the current interest rate environment. In 2017, the Company recorded gains on these instruments of $35.5 million (2016 – $10.9 million). While the gains increased net income earned in the years, there will be an offsetting negative impact to revenues as the hedged mortgages are placed or securitized in the future. For placement transactions, the impact will be immediate as the mortgages are placed with institutional investors. This was evident in the third quarter of 2017. The effect on earnings for mortgages which are securitized will be more prolonged. Generally, the Company will issue securitization-related debt at higher relative interest rates than it would have prior to the movement in bond yields. Accordingly, the negative impact will be realized over the full term of the securitization. In order to adequately hedge its interest rate exposure, the Company had more than $1.8 billion of bonds sold short as at December 31, 2017.

The portion of the Company's mortgages which is held at fair value (primarily those funded through ABCP) is also affected by changes in bond prices. Generally, higher bond yields decrease the relative value of these mortgages. However, this mortgage portfolio is much smaller than the Company's short bond position, such that the impact to earnings is typically lower. The mortgages were positively affected by a moderate tightening of mortgage funding credit spreads experienced in 2017. In 2016, these credit spreads widened to offset the positive impact of lower bond yields on such mortgages. Altogether, these mortgages lost $25.3 million of fair value in 2017 (2016 - $4.6 million). The valuation of interest rate swaps, which are used to augment the Company's short Canada hedging program, as well as to manage the interest rate exposure from fixed-rate mortgages in the ABCP portfolio, was positively affected in 2017 by changing bond yields such that unrealized gains of $47.1 million were recorded in 2017 (2016 - $21.9 million).

Brokerage Fees Expense

Brokerage fees expense decreased 20% to $83.3 million from $103.7 million. This decrease is explained almost entirely by lower origination volumes of single-family mortgages for institutional investors, which decreased by 19%. Generally, per unit broker fees for insured mortgages increased with competition in 2017. However, as the Company securitizes a significant amount of its insured single-family volume, such costs are capitalized and are amortized into income against net interest – securitized mortgages.

Salaries and Benefits Expense

Salaries and benefits expense increased by 12% to $97.8 million from $87.7 million. Salaries were higher despite lower overall headcount which decreased by 1% from 949 employees at the end of December 2016 to 936 as of the end of December 2017. The increase in overall costs relates primarily to higher compensation earned by commercial sales staff on higher volumes, which accounts for $6.7 million or 8% of the 12% increase. Although overall headcount is lower, the change represents reductions in lower salaried positions offset by new higher paying roles as the Company invests in technology. The regular cost of living increases between the years also had an impact. Management salaries were paid to the two senior executives (Co-founders) who together control about 74% of the Company's common shares. The current period expense is a result of the compensation arrangement executed on the closing of the initial public offering ("IPO").

Interest Expense

Interest expense increased 21% to $46.4 million from $38.3 million. As discussed in the "Liquidity and Capital Resources" section of this analysis, the Company warehouses a portion of the mortgages it originates prior to settlement with the ultimate investor or funding with a securitization vehicle. The Company used the senior unsecured notes together with a $1.06 billion credit facility with a syndicate of banks and 30-day repurchase facilities to fund the mortgages during this period. The overall interest expense has increased from the prior period due to higher short-term interest rates pursuant to Bank of Canada announcements which effectively increased borrowing rates by 0.50% beginning in the third quarter of 2017. The Company also held marginally higher balances of mortgages accumulated for sale or securitization, which required greater use of the Company's credit facilities.

Other Operating Expenses and Amortization of Intangibles Expenses

Other operating expenses increased by 7% to $53.9 million from $50.3 million. The amortization of intangible assets recognized on the IPO was $5.0 million per year until mid-2016 when they became fully amortized. Accordingly in 2016, the amortization expense was $2.5 million for the year but nil in 2017. Other operating expenses increased by $6.1 million related almost entirely to higher hedge expenses which increased in step with higher bond yields and a larger hedge book. Because of more mortgages originated for securitization, the Company increased notional hedges by $900 million between the 2016 year end and the 2017 year end. In addition, the rising interest rate environment has created a steeper yield curve which makes it more expensive to carry the short bonds the Company employs to mitigate interest rate risk associated with the Company's commitment and funded warehouse pipeline.

Income before Income Taxes and Pre-FMV EBITDA

Income before income taxes increased 4% to $285.4 million from $274.1 million. This increase was affected by changing capital markets, which had a favorable impact on the Company's economic interest rate hedges. In 2017, the Company recorded $56.3 million of gains on financial instruments as bond prices fell. In 2016 the results were also positive but lower and the Company recorded $27.8 million of gains on financial instruments. The change in these amounts accounts for a $28.5 million increase in income before income taxes. Pre-FMV EBITDA, which eliminates the impact of gains and losses on financial instruments, decreased by 8% to $234.3 million from $253.5 million. The decrease was due in part to the movement of interest rates through the second and third quarters of 2017. The Company calculates that $14.4 million of gains recorded in the second quarter 2017 relate to placement fees transactions entered into in the third quarter of 2017. By allocating such income to match the economics of the transactions, as opposed to the required accounting convention, management considers the 2017 comparative to 2016's Pre-FMV EBITDA to be approximately $248.7 million or down 2% from the prior year. This normalized decrease generally pertains to tighter spreads on deferred placement fees and higher hedging expenses.

Provision for Income Taxes

The provision for taxes increased by 5% to $75.8 million from $72.3 million. The provision is higher due to the higher net income before income taxes earned in 2017. The overall effective tax rate is consistent between the years.

OPERATING SEGMENT REVIEW

The Company aggregates its business from two segments for financial reporting purposes: (i) Residential (which includes single-family residential mortgages); and (ii) Commercial (which includes multi-unit residential and commercial mortgages), as summarized below:

Operating Business Segments

FOR THE YEAR ENDED	RESIDENTIAL		COMMERCIAL	
($000s except percent amounts)	December 31, 2017	December 31, 2016	December 31, 2017	December 31, 2016
Originations and renewals	**$16,352,753**	$16,976,808	**$6,897,582**	$5,785,378
Percentage change	**(4%)**		**19%**	
Revenue	**827,160**	820,029	**251,608**	229,789
Percentage change	**1%**		**9%**	
Income before income taxes	**215,370**	210,995	**70,032**	63,134
Percentage change	**2%**		**11%**	
AS AT	December 31, 2017	December 31, 2016	December 31, 2017	December 31, 2016
Identifiable assets	**25,653,160**	24,718,010	**7,093,342**	5,646,679
Mortgages Under Administration	**77,422,655**	73,152,605	**24,166,498**	22,238,885

Residential Segment

Overall residential origination including renewals decreased by 4% between 2017 and 2016, while residential revenues increased by about 1%. A significant part of the change in revenue is due to the change in gains and losses on financial instruments. Excluding these changes, revenue decreased by 1% as rising interest rates decreased placement fees by an estimated $10.9 million. The net change in gains and losses on financial instruments for the residential segment of $12.6 million also affected net income before income taxes. Without the impact of this fair value change, net income before income taxes for the residential segment decreased by 5% year over year. This is also a function of rising interest rates as lower placement revenue directly affected earnings. With the exception of the issue on placement fees, the Company increased securitization income and mortgage servicing such that income before income taxes would have grown 1% year over year. Identifiable assets increased from December 31, 2016, as the Company increased its investment in mortgages pledged under securitization by about $900 million and bonds purchased under resale agreements for hedging purposes by $400 million. This growth was offset by a decrease in mortgages accumulated for securitization by about $300 million.

Commercial Segment

2017 commercial revenues increased by about 9% compared to 2016, but increased by 3% if the impact of changes in gains and losses on the fair value of financial instruments is excluded. Generally lower deferred placement fees revenue on tighter spreads and the impact of rising rates have resulted in the drop in revenue. Excluding fair value gains and losses, net income before tax was 14% lower than in 2016, but 9% lower if adjusted for the $3.5 million impact from rising rates on placement fees as described previously. This change represents a decrease of about $5.5 million, most of which is explained by $6.3 million lower deferred placement fees and $6.7 million higher sales compensation. These unfavorable variances are offset by higher mortgage investment income of $3.5 million, increased placement fees and mortgage servicing income of $1.0 million. Loan losses were $0.8 million lower than in 2016 as the Company recovered $1.3 million of provisions originally recorded almost 10 years ago in the credit crisis. Identifiable assets increased from those at December 31, 2016, as the Company invested about $400 million in bonds purchased under resale agreements for hedging purposes, $120 million in net new mortgage investments, $550 million in mortgages pledged for securitization and $275 in mortgages accumulated for securitization.

Liquidity and Capital Resources

The Company's fundamental liquidity strategy has been to invest in prime Canadian mortgages. Management's belief has always been that these mortgages are considered "AAA" by investors and should always be well bid and highly liquid. This strategy proved effective during the turmoil experienced in 2007 through 2009, when capital markets faltered and only the highest-quality assets were bid. As the Company's results in those years demonstrated, First National had little trouble finding investors to purchase its mortgage origination at profitable margins. Originating prime mortgages also allows the Company to securitize in the capital markets; however, this activity requires significant cash resources to purchase and hold mortgages prior to arranging for term debt through the securitization markets. For this purpose, the Company uses the combination of the $175 million unsecured notes and the Company's revolving bank credit facility. This aggregate indebtedness is typically used to fund: (1) mortgages accumulated for sale or securitization, (2) the origination costs associated with securitization, and (3) mortgage and loan investments. The Company has a credit facility with a syndicate of eleven financial institutions for a total credit of $1.06 billion. This facility was extended in March 2017 for a five-year term maturing in March 2022. In September, another bank joined the syndicate with a commitment of $60 million. At December 31, 2017, the Company entered into repurchase transactions with financial institutions to borrow $1.2 billion related to $1.2 billion of mortgages held in "mortgages accumulated for sale or securitization" on the balance sheet.

At December 31, 2017, outstanding bank indebtedness was $643.8 million (December 31, 2016 - $622.9 million). Together with the unsecured notes of $175 million (December 31, 2016 – $175 million), this "combined debt" was used to fund $556.1 million (December 31, 2016 - $800.3 million) of mortgages accumulated for sale or securitization. At December 31, 2017, the Company's other interest-yielding assets included: (1) deferred placement fees receivable of $41.3 million (December 31, 2016 – $43.9 million) and (2) mortgage and loan investments of $379.7 million (December 31, 2016 - $255.2 million). The difference between "combined debt" and the mortgages accumulated for sale or securitization funded by it, which the Company considers a proxy for "true leverage", has increased between December 31, 2016 and December 31, 2017, and now stands at $262.4 million (December 31, 2016 – no true leverage). This represents a debt-to-equity ratio of approximately 0.48:1. This has increased from December 31, 2016 when there was no "debt", as generally, the Company invested $124 million in net new mortgage and loan investments, replaced $75 million of equity with debt after payment of the special dividend, invested $43 million in cash collateral to support the growing ABCP program, and paid off the non-controlling interest related to the Fund. The Company believes the ratio is appropriate given the nature of the assets which the debt is funding.

The Company funds a portion of its mortgage originations for institutional placement on the same day as the advance of the related mortgage. The remaining originations are funded by the Company on behalf of institutional investors or pending securitization on the day of the advance of the mortgage. On specified days, the Company aggregates all mortgages warehoused to date for an institutional investor and transacts a settlement with that institutional investor. A similar process occurs prior to arranging for term funding through securitization. The Company uses a portion of the committed credit facility with the banking syndicate to fund the mortgages during this warehouse period. The credit facility is designed to be able to fund the highest balance of warehoused mortgages in a month and is normally only partially drawn.

The Company also invests in short-term mortgages, usually for six- to 18-month terms, to bridge existing borrowers in the interim period between long-term financing solutions. The banking syndicate has provided credit facilities to partially fund these investments. As these investments return cash, it will be used to pay down this bank indebtedness. The syndicate has also provided credit to finance a portion of the Company's deferred placement fees receivable and the origination costs associated with securitization as well as other miscellaneous longer-term financing needs.

The Company has used ABCP as an efficient source of funding primarily for short-term insured mortgages. In the May 2013 federal budget, the government announced it was going to take steps to limit the securitization of government insured mortgages to CMHC sponsored programs. As ABCP is not sponsored by CMHC, such a limitation would impact the Company. Almost two years after the announcement, legislation was passed and detailed transition information was published. With the change in the federal government, the legislation was reconfirmed in February 2016 with some delayed application dates. Generally, the regulations make mortgage default insurance invalid for any single-family mortgages with maturity dates beyond December 31, 2021 in a non-CMHC sponsored securitization vehicle. Accordingly, existing single-family mortgages in ABCP conduits as at December 31, 2016 can be funded by ABCP until their maturity, not to exceed 5 years and new insured single-family mortgages can be sold in as long as the maturity date of the mortgage is prior to January 1, 2022. As this date approaches, the Company must find other funding sources for the insured mortgages it has historically funded with ABCP. The Company is considering various alternatives including whole loan sales and selling short-term NHA-MBS pools to ABCP conduits. The Company may also adjust its renewal offering to provide incentives to borrowers to select five-year terms as opposed to shorter terms. These alternatives may not be as economical to the Company as ABCP. A portion of the Company's capital has been employed to support its ABCP and NHA-MBS programs, primarily to provide credit enhancements as required by rating agencies. The most significant portion of cash collateral is the investment made on behalf of the Company's ABCP programs. As at December 31, 2017, the investment in cash collateral was $66.4 million (December 31, 2016 - $22.9 million).

The Company's Board of Directors has elected to pay dividends, when declared, on a monthly basis on the outstanding common shares and on a quarterly basis on the outstanding preference shares. For purposes of the enhanced dividend tax credit rules contained in the Income Tax Act (Canada) and any corresponding provincial and territorial tax legislation, all dividends (and deemed dividends) paid by the Company to Canadian residents on both common and preference shares after December 31, 2010, are designated as "eligible dividends". Unless stated otherwise, all dividends (and deemed dividends) paid by the Company hereafter are designated as "eligible dividends" for the purposes of such rules. For the preference shares, the Company has elected to pay any tax under Part VI.1 of the Income Tax Act, such that corporate holders of the shares will not be required to pay tax under Part VI.1 of the Income Tax Act on dividends received on such shares.

Financial Instruments and Risk Management

The Company has elected to treat deferred placement fees receivable, certain mortgages pledged under securitization that have been funded with ABCP and NHA-MBS debt and several mortgages within mortgage and loan investments, as financial assets measured at "fair value through profit or loss" such that changes in market value are recorded in the consolidated statement of comprehensive income. Effectively, these assets are treated much like bonds earning the Company a coupon at the discount rates used by the Company. The discount rates used represent the interest rate associated with a risk-free bond of the same duration plus a premium for the risk/uncertainty of the asset's residual cash flows. As rates in the bond market change, the carrying values of these assets will change. These changes may be significant (favourable and unfavourable) from quarter to quarter. The Company enters into fixed-for-float swaps to manage the interest rate exposure of fixed mortgages sold to ABCP conduits. These instruments will also be treated as fair value through profit or loss. While the Company has attempted to exactly match the principal balances of the fixed mortgages over the next five-year period to the notional swap values for the same period, there will be differences in these amounts. Any favourable or unfavourable amounts will be recorded in the statement of comprehensive income each quarter.

The Company believes its hedging policies are suitably designed such that the interest rate risk of holding mortgages prior to securitization is mitigated. From an accounting perspective, any gains or losses on these instruments are recorded in the current period, as the Company's economic hedging strategy does not qualify as hedging for accounting purposes. The Company uses synthetic bond forwards (consisting of bonds sold short and bonds purchased under resale agreements) to manage interest rate exposure between the time a mortgage rate is committed to the borrower and the time the mortgage is transferred to the securitization vehicle and the matched term debt is arranged. As interest rates change, the value of these short bonds will vary inversely with the value of the related mortgages. As interest rates increase, a gain will be recorded on the bonds, which should be offset by a tighter interest rate spread between the interest rates on mortgages and the securitization debt. This spread will be earned over the term of the related mortgages. For single-family mortgages, primarily mortgages for the Company's own securitization programs, only some of the mortgage commitments issued by the Company eventually fund. The Company must assign a probability of funding to each mortgage in the pipeline and estimate how that probability changes as mortgages move through the various stages of the pipeline. The amount that is actually hedged is the expected value of mortgages funding within the next 120 days (120 days being the standard maximum rate hold period available for the mortgages). As at December 31, 2017, the Company had more than $1.5 billion of notional forward bond positions related to its single-family programs. For multi-unit residential and commercial mortgages, the Company assumes all mortgages committed will fund, and hedges each mortgage individually. This includes mortgages committed for the CMB program as well as mortgages for transfer to the Company's other securitization vehicles. As at December 31, 2017, the Company had entered into $348 million of notional value forward bond sales for this segment. The total net value of realized and unrealized gains and losses on account of all notional hedges pertaining to 2017 was a $35.5 million gain. This amount has been included in revenue in the statement of comprehensive income.

The Company is party to three interest rate swaps that economically hedge the interest rate exposure related to certain CMB transactions in which the Company has replacement obligations. As at December 31, 2017, the aggregate notional value of these swaps was $16.4 million. During 2017, the value of these swaps decreased by $0.9 million. The swaps mature between June 2021 and December 2026.

As described above, the Company employs various strategies to reduce interest rate risk. In the normal course of business, the Company takes some credit spread risk. This is the risk that the credit spread at which a mortgage is originated changes between the date of commitment of that mortgage and the date of sale or securitization. This can be illustrated by the Company's experience with commercial mortgages originated for the CMBS market in the spring of 2007. These mortgages were originated at credit spreads designed to be profitable to the Company when sold to a bank-sponsored CMBS conduit. Unfortunately for the Company, when these mortgages funded, the CMBS market had shut down. The alternative to this channel was more expensive, as credit spreads elsewhere in the marketplace for this type of mortgage had widened. The Company adjusted for market-suggested increases in credit spreads in 2007 and 2008, adjusting the value of the mortgages downward. In 2009, the economic environment remained weak but did not worsen from what it was at the end of 2008. Overall credit spreads stopped widening such that the Company applied the same spreads to these mortgages and the Company did not record any additional unrealized losses or gains related to credit spread movement. Despite entering into effective economic interest rate hedges, the Company's exposure to credit spreads remained. This risk is inherent in the Company's business model and cannot be economically hedged.

The same exposure to risk is inherent in the Company's securitization through ABCP. The Company is exposed to the risk that 30-day ABCP rates are greater than 30-day BA rates. Prior to the financial crisis, the Company considered this a low risk given the quality of the assets securitized, the amount of credit enhancements provided by the Company and the strong covenant of the bank-sponsored conduits with which the Company transacted. In 2008, 30-day ABCP traded at approximately 1.10 percentage points over BAs; but by the end of June 2011 and continuing through the current period, it was priced at a discount to BAs. At the same time the Company has leveraged on changing credit spreads. The success of this approach has been demonstrated through the increase in volume and profitability of the NHA-MBS program and significant increases in gains on deferred placement fees from the sale of prime insured mortgages. As at December 31, 2017, the Company had various exposures to changing credit spreads. In particular, in mortgages accumulated for sale or securitization, there were almost $1.8 billion of mortgages that are susceptible to some degree of changing credit spreads.

Capital Expenditures

A significant portion of First National's business model consists of the origination and placement or securitization of financial assets. Generally, placement activities do not require much capital investment as the Company acts primarily in the capacity of a broker. On the other hand, the undertaking of securitization transactions may require significant amounts of the Company's own capital. This capital is provided in the form of cash collateral, credit enhancements, and the upfront funding of broker fees and other origination costs. These are described more fully in the "Liquidity and Capital Resources" section above. For fixed assets, the business requires capital expenditures on technology (both software and hardware), leasehold improvements, and office furniture. During the year ended December 31, 2017, the Company purchased new computer equipment and leasehold improvements. In the long term, the Company expects capital expenditures on fixed assets will be approximately $5.0 million annually.

'A significant portion of First National's business model consists of the origination and placement or securitization of financial assets.'

Summary of Contractual Obligations

The Company's long-term obligations include five- to 10-year leases of premises for its six offices across Canada, and its obligations for the ongoing servicing of mortgages sold to securitization conduits and mortgages related to purchased servicing rights. The Company sells its mortgages to securitization conduits on a fully-serviced basis, and is responsible for the collection of the principal and interest payments on behalf of the conduits, including the management and collection of mortgages in arrears.

	PAYMENTS DUE BY PERIOD				
($000s)	**Total**	0-1 Years	1-3 Years	4-5 Years	After 5 Years
Lease obligations	$25,473	$6,697	$13,319	$5,458	$—

Critical Accounting Policies and Estimates

The Company prepares its financial statements in accordance with IFRS, which requires management to make estimates, judgments and assumptions that management believes are reasonable based upon the information available. These estimates, judgments and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Management bases its estimates on historical experience and other assumptions that it believes to be reasonable under the circumstances. Management also evaluates its estimates on an ongoing basis. The significant accounting policies of First National are described in Note 2 to the Company's annual consolidated financial statements as at December 31, 2017. The policies which First National believes are the most critical to aid in fully understanding and evaluating its reported financial results include the determination of the gains on deferred placement fees and the impact of fair value accounting on financial instruments.

The Company uses estimates in valuing its gain or loss on the sale of its mortgages placed with institutions earning a deferred placement fee. Under IFRS, valuing a gain on deferred placement fees requires the use of estimates to determine the fair value of the retained interest (derived from the present value of expected future cash flows) in the mortgages. These retained interests are reflected on the Company's balance sheet as deferred placement fees receivable. The key assumptions used in the valuation of gains on deferred placement fees are prepayment rates and the discount rate used to present value future expected cash flows. The annual rate of unscheduled principal payments is determined by reviewing portfolio prepayment experience on a monthly basis. The Company uses different rates for its various programs, which average approximately 11% for single-family mortgages. The Company assumes there is virtually no prepayment on multi-unit residential fixed-rate mortgages.

On a quarterly basis, the Company reviews the estimates used to ensure their appropriateness and monitors the performance statistics of the relevant mortgage portfolios to adjust and improve these estimates. The estimates used reflect the expected performance of the mortgage portfolio over the lives of the mortgages. The method of determining the assumptions underlying the estimates used for the quarter ended December 31, 2017 continue to be consistent with those used for the year ended December 31, 2016 and the quarters ended September 30, June 30 and March 31, 2017.

The Company has elected to treat certain of its financial assets and liabilities, including deferred placement fees receivable, specific mortgages pledged under securitization, some mortgage and loan investments and bonds sold short, at fair value through profit or loss. Essentially, this policy requires the Company to record changes in the fair value of these instruments in the current period's earnings. The Company's assets and liabilities are such that the Company must use valuation techniques based on assumptions that are not fully supported by observable market prices or rates in most cases. Much like the valuation of deferred placement fees receivable described above, the Company's method of determining the fair value of its securitized mortgages has a significant impact on earnings. The Company uses different prepayment rates for its various programs, which average approximately 10% for single-family mortgages. The Company assumes there is virtually no prepayment on multi-unit residential fixed-rate mortgages. Actual prepayment experience has been consistent with these assumptions. The Company has also assumed discount rates based on Government of Canada bond yields, plus a spread that the Company believes would enable a third party to purchase the mortgages and make a normal profit margin for the risk involved.

Future Accounting Changes

The following accounting pronouncements issued by the IASB, although not yet effective, may have a future impact on the Company:

IFRS 9 – Financial Instruments

In July 2014, the International Accounting Standard Board ("IASB") issued the final version of IFRS 9 – Financial Instruments, replacing IAS 39 and all previous versions of IFRS 9. This final version of IFRS 9 includes a model for classification and measurement, a single, forward-looking "expected loss" impairment model and a substantially-reformed approach to hedge accounting. Under this standard, financial assets are classified and measured based on the business model in which they are held and the characteristics of their contractual cash flows. The accounting model for financial liabilities is largely unchanged from IAS 39, except for the presentation of the impact of own credit risk on financial liabilities, which will be recognized in other comprehensive income ("OCI"), rather than in profit and loss as under IAS 39. The new general hedge accounting principles under IFRS 9 are aimed to align hedge accounting more closely with risk management. This new standard does not fundamentally change the types of hedging relationships or the requirement to measure and recognize ineffectiveness; however, it is expected to provide more hedging strategies that are used for risk management to qualify for hedge accounting and introduce more judgment to assess the effectiveness of a hedging relationship. IFRS 9 is effective for annual periods beginning on or after January 1, 2018.

Classifications and Measurement

IFRS 9 requires that all financial assets are to be measured at either at FVTPL, fair value through OCI ["FVOCI"], or amortized cost. Based on its business models, the Company has determined which measurement convention is most appropriate for its mortgage assets as summarized below with a comparison to the classification and measurement under IAS 39:

	IAS 39	IFRS 9
Mortgages accumulated for securitization	Loans and Receivable	Amortized Cost
Mortgages accumulated for sale	FVTPL	FVTPL
Mortgages pledged under securitization	FVTPL or Loan and Receivables	Amortized Cost
Mortgage and loan investments	Loans and Receivable	FVTPL

As at December 31, 2017, the mortgages pledged under securitization which were classified as FVTPL had a mark to market discount to par of $1,683. This amount will be amortized to interest revenue over the term of the related mortgages.

Impairment

IFRS 9 introduces an expected credit loss ["ECL"] model applicable to all debt instrument within financial assets classified as amortized cost or FVOCI and certain off-balance sheet loan commitments. The model has three stages: Stage 1 – the credit risk has not increased significantly since initial recognition such that an allowance for credit loss is recognized and maintained equal to 12 months of expected credit loss: Stage 2 – the credit risk has increased significantly since initial recognition, and the allowance for credit loss is increased to cover full lifetime expected credit loss; and Stage 3 – a financial asset is considered credit-impaired and the allowance for credit loss continues to be the full lifetime expected credit loss, with interest revenue calculated on the carrying amount (net of the allowance for credit loss), rather than the gross carrying value of the financial assets.

The Company's ECL model will be built on an unbiased and probability-weighted method, determined by evaluating a range of possible outcomes. The model will consider the time value of money. Based on the initial analysis, the Company is not expecting a significant impact from the adoption of the impairment loss policy on its consolidated financial statements due to the high proportion of government insured mortgages in its securitized portfolio and the low historical loss rates on the uninsured mortgages on which the Company lends.

Hedge Accounting

The Company is planning to adopt hedge accounting for certain mortgage commitments and funded mortgages.

For multi-unit residential commercial segment mortgages, the Company will apply cash flow hedge accounting by hedging the anticipated future debt to be arranged on these mortgages. The Company will use short sales of Government of Canada bonds at the time of mortgage commitment as the hedging instrument. When effective hedging is achieved, any gains or losses will be recorded in OCI and amortized into interest expense over the term of the hedged debt.

For residential mortgages accumulated for securitization, the Company will apply fair value hedge accounting to minimize the exposure to changing interest rates by selling short Government of Canada bonds at the time these mortgages are funded. The Company will re-balance and evaluate the hedge effectiveness on an ongoing basis. For an effective hedge, the gains or losses on the hedging instrument will be offset by the losses or gains on the hedged mortgages. At hedge unwind, the changes in the value of the hedging instrument will be adjusted to the carrying value of the hedged mortgages, and amortized into interest revenue over the term of the hedged mortgages. Any changes in the market value of the ineffective hedge will be immediately recorded in the Company's regular income.

The Company will continue to evaluate the impact of IFRS 9 on the Company's consolidated financial statements, but is not expecting any restatement of comprehensive income for prior years.

IFRS 15 – Revenue from Contracts with Customers

In May 2014, the IASB issued IFRS 15 – Revenue from Contracts with Customers, replacing IAS 11 – Construction Contracts, IAS 18 – Revenue, IFRIC 13 – Customer Loyalty Programs, IFRIC 15 – Agreements for the Construction of Real Estate, IFRIC 18 – Transfer of Assets from Customers, and SIC 31 – Revenue – Barter Transactions Involving Advertising Services. The standard contains a single model that applies to contracts with customers and two approaches to recognizing revenue: at a point in time or over time. The model features a contract-based five-step revenue recognition process to determine the nature, amount, timing and uncertainty of revenue and cash flows from the contracts with customers. IFRS 15 is effective for fiscal years beginning on or after January 1, 2018, and can be applied on a retrospective basis or using a modified retrospective approach.

The Company plans to apply the standard on January 1, 2018, using the modified retrospective approach. The main revenue stream that will be affected by IFRS 15 is mortgage servicing revenue, including the ongoing measurement of servicing liabilities. Based on the initial analysis, the Company does not currently expect a material impact of IFRS 15 on its consolidated financial statements, and is not expecting any restatement of comprehensive income for prior years.

IFRS 16 – Leases

In January 2016, the IASB issued IFRS 16 – Leases, replacing IAS 17 – Leases. IFRS 16 requires lessees to recognize assets and liabilities for most leases instead of previous categories of finance leases, which are reported on the balance sheet, or operating leases, which are disclosed only in the notes to the financial statements, under IAS 17. IFRS 16 is effective for annual periods beginning on or after January 1, 2019. Early adoption is permitted for companies that also adopt IFRS 15. The Company is currently assessing the impact of this standard on the Company's consolidated financial statements.

Disclosure Controls and Internal Controls Over Financial Reporting

The Company's disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by the Company in reports filed under Canadian securities laws is recorded, processed, summarized and reported within the time periods specified under those laws, and include controls and procedures that are designed to ensure that information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

As of December 31, 2017, management evaluated, under the supervision of and with the participation of the Chief Executive Officer and Chief Financial Officer, the effectiveness of the Company's disclosure controls and procedures. Based on this evaluation, management concluded that the Company's disclosure controls and procedures, as defined by National Instrument 52-109, Certification of Disclosure in Issuers' Annual and Interim Filings, were effective as of December 31, 2017.

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with reporting standards; however, because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements on a timely basis.

Management evaluated, under the supervision of and with the participation of the Chief Executive Officer and Chief Financial Officer, the effectiveness of the Company's internal control over financial reporting based on the criteria set forth in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") and, based on that evaluation, concluded that the Company's internal control over financial reporting was effective as of December 31, 2017 and that no material weaknesses have been identified in the Company's internal control over financial reporting as of December 31, 2017. No changes were made in the Company's internal controls over financial reporting during the year ended December 31, 2017 that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

Risks and Uncertainties Affecting the Business

The business, financial condition and results of operations of the Company are subject to a number of risks and uncertainties, and are affected by a number of factors outside the control of management of the Company. In addition to the risks addressed elsewhere in this discussion and the financial statements, these risks include: ability to sustain performance and growth, reliance on sources of funding, concentration of institutional investors, reliance on independent mortgage brokers, changes in interest rates, repurchase obligations and breach of representations and warranties on mortgage sales, risk of servicer termination events and trigger events on cash collateral and retained interests, reliance on multi-unit residential and commercial mortgages, general economic conditions, legislation and government regulation (including regulations imposed by the Department of Finance, CMHC and the policies set by and for mortgage default insurance companies), potential for losses on uninsured mortgages, competition, reliance on mortgage insurers, reliance on key personnel and the ability to attract and retain employees and executives, conduct and compensation of independent mortgage brokers, failure or unavailability of computer and data processing systems and software, insufficient insurance coverage, change in or loss of ratings, impact of natural disasters and other events, and environmental liability. In addition, there are risks associated with the structure of the Company including: those related to the dependence on FNFLP, leverage and restrictive covenants, dividends which are not guaranteed and could fluctuate with the Company's performance, restrictions on potential growth, the market price of the Company's shares, statutory remedies, control of the Company, and contractual restrictions.

The Company is subject to Canadian federal and provincial income and commodity tax laws and pays such taxes as it determines are compliant with such legislation. Among the risks of all potential tax matters, there is a risk that tax legislation changes are detrimental to the Company or that Canadian tax authorities interpret tax legislation differently than the Company's filing positions.

Risk and risk exposure are managed through a combination of insurance, a system of internal controls and sound operating practices. The Company's key business model is to originate primarily prime mortgages and find funding through various channels to earn ongoing servicing or spread income.

For the single-family residential segment, the Company relies on independent mortgage brokers for origination and several large institutional investors for sources of funding. These relationships are critical to the Company's success. For a more complete discussion of the risks affecting the Company, reference should be made to the Company's Annual Information Form.

Forward-Looking Information

Forward-looking information is included in this MD&A. In some cases, forward-looking information can be identified by the use of terms such as "may", "will", "should", "expect", "plan", "anticipate", "believe", "intend", "estimate", "predict", "potential", "continue" or other similar expressions concerning matters that are not historical facts. Forward-looking information may relate to management's future outlook and anticipated events or results, and may include statements or information regarding the future financial position, business strategy and strategic goals, product development activities, projected costs and capital expenditures, financial results, risk management strategies, hedging activities, geographic expansion, licensing plans, taxes and other plans and objectives of or involving the Company. Particularly, information regarding growth objectives, any increase in mortgages under administration, future use of securitization vehicles, industry trends and future revenues is forward-looking information.

Forward-looking information is based on certain factors and assumptions regarding, among other things, interest rate changes and responses to such changes, the demand for institutionally placed and securitized mortgages, the status of the applicable regulatory regime, and the use of mortgage brokers for single-family residential mortgages. This forward-looking information should not be read as providing guarantees of future performance or results, and will not necessarily be an accurate indication of whether or not, or the times by which, those results will be achieved. While management considers these assumptions to be reasonable based on information currently available to it, they may prove to be incorrect. Forward-looking information is subject to certain factors, including risks and uncertainties, which could cause actual results to differ materially from what management currently expects. These factors include reliance on sources of funding, concentration of institutional investors, reliance on independent mortgage brokers, and changes in interest rates as outlined in the "Risk and Uncertainties Affecting the Business" section. In evaluating this information, the reader should specifically consider various factors, including the risks outlined in the "Risk and Uncertainties Affecting the Business" section, which may cause actual events or results to differ materially from any forward-looking information. The forward-looking information contained in this discussion represents management's expectations as of February 27, 2018, and is subject to change after such date. However, management and the Company disclaim any intention or obligation to update or revise any forward-looking information, whether as a result of new information, future events or otherwise, except as required under applicable securities regulations.

Outlook

Management is pleased with the results of 2017. As expected, the market for high ratio insured mortgages slowed as a result of the October 2016 mortgage insurance rules announced by the Department of Finance. Although single-family mortgage originations for the Company were down 10% from 2016, commercial mortgage origination increased by 20% and single-family renewals grew by 15% to $5.2 billion. Altogether, origination including renewals was up 2% and earnings, adjusted for fair value considerations, were lower by 2%. The combination of consistent revenue from both securitization and servicing departments and the value inherent in the Company's renewal opportunities continued to support earnings. Management believes that fourth quarter new single-family origination, which increased year over year by 3%, benefited from new mortgage qualification rules announced for 2018. The new rules require conventional mortgage borrowers to qualify at interest rates higher than the actual rate of the mortgage. Accordingly, the new rules reduce the relative size of mortgage that a borrower could otherwise have taken on under the previous rules. The Company believes this pushed some borrowers to accelerate their decision to purchase real estate into 2017, so as to qualify under the old rules which has had a positive impact on these volumes.

Going into 2018, the Company is optimistic and anticipates similar seasonal origination in the residential segment as experienced in 2017. Despite the impact of new qualifying mortgage rules announced in late 2017, which will have a dampening effect on origination volumes, the Company currently foresees a strong economy which will offset these effects. The Company sees growth in single-family renewals and a stable commercial segment muted by a rising interest rate environment and some increased competition.

The Company earned almost $56 million in gains on financial instruments in 2017. While this revenue increased 2017 net income, the offsetting economic impact will be felt in the Company's future earnings. Net securitization margins will be lower on new securitizations as the Company issues NHA-MBS with coupons that will be higher than the period when the securitized mortgages were initially funded. The negative impact will be recognized over the five- and 10-year terms of the securitization. However, to the extent that the funded mortgages are placed with institutional customers, as the Company did in 2017, the impact will be immediate with lower placement fees in current period earnings. Depending on how the Company elects to fund these mortgage assets, the negative impact associated with the large gains recorded in 2017 could be spread over five- or 10-year terms or it could be realized in the upcoming fiscal year.

The Company will continue to generate income and cash flow from its $27 billion portfolio of mortgages pledged under securitization and $74 billion servicing portfolio, and focus on the value inherent in its significant single-family renewal book.

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The management of First National Financial Corporation (the "Company") is responsible for the integrity, consistency and reliability of the consolidated financial statements and Management's Discussion and Analysis ("MD&A"). The consolidated financial statements have been prepared by Management in accordance with International Financial Reporting Standards.

We certify that we have reviewed the financial statements and information contained in the MD&A, and, based on our knowledge, they do not contain any untrue statement of a material fact or omit to state a material fact required to be stated or that is necessary to make a statement not misleading in light of the circumstances under which it was made, with respect to the period covered by the statements and the annual report. Based on our knowledge, the financial statements together with MD&A and other financial information included in the annual report fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of the dates and for the periods presented. The preparation of financial statements involves transactions affecting the current period which cannot be finalized with certainty until future periods. Estimates and assumptions are based on historical experience and current conditions, and are believed to be reasonable.

We are responsible for establishing and maintaining internal control over financial reporting for the Company. We have designed such internal control over financial reporting, or caused it to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes. We evaluated, or caused to be evaluated under our supervision, the effectiveness of the Company's internal control over financial reporting at the financial year end and the Company has disclosed in its annual MD&A our conclusion about the effectiveness of internal control over financial reporting at the financial year-end based on that evaluation. We have also disclosed in the MD&A any change in our internal control over financial reporting that occurred during the year that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

The Board of Directors oversees that management fulfills its responsibility for financial reporting and internal control. The financial statements have been reviewed by the Audit Committee and approved by the Board of Directors. Ernst & Young LLP, the independent auditors appointed by the shareholders, has performed an independent audit of the Company's consolidated financial statements and provide their report which follows. The auditors have full and free access to, and meet at least quarterly with, the Audit Committee to discuss their audit and related matters.

Stephen Smith

Stephen Smith
Chairman and Chief Executive Officer

Robert Inglis
Chief Financial Officer

February 27, 2018

INDEPENDENT AUDITORS' REPORT

TO THE SHAREHOLDERS OF FIRST NATIONAL FINANCIAL CORPORATION

We have audited the accompanying consolidated financial statements of First National Financial Corporation, which comprise the consolidated statements of financial position as at December 31, 2017 and 2016, and the consolidated statements of comprehensive income, changes in equity and cash flows for the years then ended, and 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 audits 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 the auditors' 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, the auditors 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 financial position of First National Financial Corporation as at December 31, 2017 and 2016, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Ernst & Young LLP

Chartered Professional Accountants
Licensed Public Accountants

Toronto, Canada
February 27, 2018

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

As at December 31

(in thousands of Canadian dollars)	Notes	2017	2016
ASSETS			
Restricted cash	3	**$561,470**	$685,347
Cash held as collateral for securitization	3	**66,413**	22,877
Accounts receivable and sundry		**144,159**	91,701
Securities purchased under resale agreements and owned	14	**2,185,362**	1,307,801
Mortgages accumulated for sale or securitization	5	**1,789,765**	1,837,916
Mortgages pledged under securitization	3	**27,566,677**	26,106,664
Deferred placement fees receivable	4	**41,273**	43,933
Mortgage and loan investments	6	**379,713**	255,230
Other assets	7	**41,446**	42,996
Total assets		**$32,776,278**	$30,394,465
LIABILITIES AND EQUITY			
Liabilities			
Bank indebtedness	9	**$643,828**	$628,522
Obligations related to securities and mortgages sold under repurchase agreements	15	**1,200,135**	1,009,572
Accounts payable and accrued liabilities	16	**118,081**	122,499
Securities sold under repurchase agreements and sold short	14	**2,180,253**	1,308,483
Debt related to securitized and participation mortgages	10	**27,834,080**	26,514,181
Senior unsecured notes	12	**174,693**	174,556
Income taxes payable	18	**7,191**	23,255
Deferred tax liabilities	18	**74,750**	63,100
Total liabilities		**$32,233,011**	$29,844,168
EQUITY ATTRIBUTABLE TO SHAREHOLDERS			
Common shares	17	**$122,671**	$122,671
Preferred shares	17	**97,394**	97,394
Retained earnings		**323,202**	302,271
		543,267	522,336
Non-controlling interests		**—**	27,961
Total equity		**$543,267**	$550,297
Total liabilities and equity		**$32,776,278**	$30,394,465

See accompanying notes

On behalf of the Board:

John Brough

Robert Mitchell

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Years ended December 31

(in thousands of Canadian dollars, except earnings per share)	Notes	2017	2016
REVENUE			
Interest revenue – securitized mortgages		**$658,783**	$639,972
Interest expense – securitized mortgages		**(511,939)**	(495,681)
Net interest – securitized mortgages	3	**146,844**	144,291
Placement fees		**144,589**	176,856
Gains on deferred placement fees	4	**10,020**	16,332
Mortgage investment income		**68,276**	57,480
Mortgage servicing income		**140,841**	131,428
Realized and unrealized gains (losses) on financial instruments	19	**56,259**	27,750
		$566,829	$554,137
EXPENSES			
Brokerage fees		**$83,260**	$103,719
Salaries and benefits		**97,824**	87,744
Interest		**46,428**	38,275
Other operating		**53,915**	47,770
Amortization of intangible assets		**—**	2,500
		$281,427	$280,008
Income before income taxes		**$285,402**	$274,129
Income tax expense	18	**75,750**	72,300
Net income and comprehensive income for the year		**209,652**	201,829
Net income and comprehensive income attributable to:			
Shareholders		**208,078**	199,744
Non-controlling interests		**1,574**	2,085
		$209,652	$201,829
Earnings per share			
Basic	17	**3.42**	3.28

See accompanying notes

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

Years ended December 31

(in thousands of Canadian dollars)	**Common shares**	**Preferred shares**	**Retained earnings**	**Non-controlling interest**	**Total equity**
Balance as at January 1, 2017	$122,671	$97,394	$302,271	$27,961	$550,297
Comprehensive income	—	—	208,078	1,574	209,652
Dividends paid or declared	—	—	(187,147)	(1,535)	(188,682)
Redemptions by non-controlling interests	—	—	—	(28,000)	(28,000)
Balance as at December 31, 2017	**$122,671**	**$97,394**	**$323,202**	**—**	**$543,267**

	Common shares	Preferred shares	Retained earnings	Non-controlling interest	Total equity
Balance as at January 1, 2016	$122,671	$97,394	$204,686	$32,779	$457,530
Comprehensive income	—	—	199,744	2,085	201,829
Dividends paid or declared	—	—	(102,159)	(1,960)	(104,119)
Redemptions by non-controlling interests	—	—	—	(4,943)	(4,943)
Balance as at December 31, 2016	**$122,671**	**$97,394**	**$302,271**	**$27,961**	**$550,297**

See accompanying notes

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31

(in thousands of Canadian dollars)	2017	2016
OPERATING ACTIVITIES		
Net income for the year	**$209,652**	$201,829
Add (deduct) items not affecting cash		
Deferred income tax expense	**11,650**	7,700
Non-cash portion of gains on deferred placement fees	**(9,452)**	(15,857)
Increase in restricted cash	**123,877**	(187,443)
Net investment in mortgages pledged under securitization	**(1,485,325)**	(1,587,201)
Net increase in debt related to securitized mortgages	**1,325,674**	1,785,018
Provision for loan loss	**2,740**	3,500
Amortization of deferred placement fees receivable	**11,082**	9,623
Amortization of purchased mortgage servicing rights	**664**	652
Amortization of property, plant and equipment	**5,135**	4,660
Amortization of intangible assets	**—**	2,500
Unrealized losses (gains) on financial instruments	**(23,254)**	(29,907)
	172,443	195,074
Net change in non-cash working capital balances related to operations	**21,865**	(326,084)
Cash provided by (used in) operating activities	**$194,308**	$131,010
INVESTING ACTIVITIES		
Additions to property, plant and equipment	**(4,249)**	(4,633)
Repayment (investment) of cash held as collateral for securitization	**(43,536)**	6,280
Investment in mortgage and loan investments	**(475,129)**	(236,784)
Repayment of mortgage and loan investments	**347,906**	224,065
Cash used in investing activities	**$(175,008)**	$(11,072)
FINANCING ACTIVITIES		
Dividends paid	**(188,066)**	(103,875)
Obligations related to securities and mortgages sold under repurchase agreements	**190,563**	203,722
Increase (decrease) debt related to participation mortgages	**(5,775)**	14,564
Securities purchased under resale agreements and owned, net	**(877,561)**	333,739
Securities sold under repurchase agreements and sold short, net	**874,233**	(349,932)
Repayment of debenture loan	**—**	—
Issuance of senior unsecured notes	**—**	—
Redemption by non-controlling interests	**(28,000)**	(4,943)
Cash provided by financing activities	**$(34,606)**	$96,533
Net decrease (increase) in bank indebtedness during the year	**(15,306)**	45,549
Bank indebtedness, beginning of year	**(628,522)**	(582,973)
Bank indebtedness, end of year	**$(643,828)**	$(628,522)
Supplemental cash flow information		
Interest received	**$794,240**	$770,005
Interest paid	**531,799**	512,991
Income taxes paid	**80,163**	51,548

See accompanying notes

NOTES TO **CONSOLIDATED FINANCIAL STATEMENTS**

[in thousands of Canadian dollars, unless otherwise indicated]

December 31, 2017 and 2016

NOTE 1. GENERAL ORGANIZATION AND BUSINESS OF FIRST NATIONAL FINANCIAL CORPORATION

First National Financial Corporation [the "Corporation" or "Company"] is the parent company of First National Financial LP ["FNFLP"], a Canadian-based originator, underwriter and servicer of predominantly prime residential [single family and multi unit] and commercial mortgages. With over $101 billion in mortgages under administration as at December 31, 2017, FNFLP is a significant participant in the mortgage broker distribution channel.

The Corporation is incorporated under the laws of the Province of Ontario, Canada and has its registered office and principal place of business located at 100 University Avenue, Toronto, Ontario. The Corporation's common and preferred shares are listed on the Toronto Stock Exchange under the symbols FN, FN.PR.A and FN.PR.B, respectively.

NOTE 2. SIGNIFICANT ACCOUNTING POLICIES

[A] BASIS OF PREPARATION

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ["IFRS"]. The consolidated financial statements have been prepared on a historical cost basis, except for derivative financial instruments and financial assets and financial liabilities that are recorded at fair value through profit or loss ["FVTPL"] and measured at fair value. The carrying values of recognized assets and liabilities that are hedged items in fair value hedges, and otherwise carried at amortized cost, are adjusted to record changes in fair value attributable to the risks that are being hedged. The consolidated financial statements are presented in Canadian dollars and all values are rounded to the nearest thousand except when otherwise indicated. The consolidated financial statements were authorized for issue by the Board of Directors on February 27, 2018.

[B] BASIS OF CONSOLIDATION

The consolidated financial statements comprise the financial statements of the Company and its subsidiaries, including FNFLP, First National Financial GP Corporation [the general partner of FNFLP], FNFC Trust, a special purpose entity ["SPE"] which is used to manage undivided co ownership interests in mortgage assets funded with Asset-Backed Commercial Paper ["ABCP"], First National Asset Management Inc., First National Mortgage Corporation, First National Mortgage Investment Fund [the "Fund"], and FN Mortgage Investment Trust [the "Trust"].

The Fund and the Trust were created in 2012 as special purpose vehicles to obtain exposure to a diversified portfolio of high yielding mortgages. Pursuant to the trustee's determination, both the Fund and the Trust were terminated on December 19, 2017. While the Fund and Trust operated, because of its status as the sole seller of assets to the Fund and its rights as promoter, the Company determined that it had de facto control of both the Fund and the Trust, and therefore, consolidated the operations and net assets of the Fund and the Trust. Non controlling interests in the Fund and the Trust were shown as a separate component of equity on the consolidated statements of financial position to distinguish them from the equity of the Company's shareholders. The net income attributable to non-controlling interests is also separately disclosed on the consolidated statements of comprehensive income. On termination, the Company effectively made a payment to the non-controlling interest to redeem in full their interest in the net assets of the Fund and Trust.

The Company does not consolidate, in its financial statements, three SPEs [2016 – one] over which the Company does not have control. The SPEs are sponsored by third-party financial institutions which acquire assets from various sellers including mortgages from the Company. The Company earns interest income from the retained interest related to these mortgages. As at December 31, 2017, the Company recorded, on its consolidated statements of financial position, its portion of the assets of the SPEs amounting to $800 million [2016 – $243 million]. The Company also recorded, in its consolidated statements of comprehensive income, interest revenue – securitized mortgages of $8.2 million [2016 – $4.6 million] and interest expense – securitized mortgages of $7.7 million [2016 – $3.5 million] related to its interest in the SPEs.

The consolidated financial statements have been prepared using consistent accounting policies for like transactions and other events in similar circumstances. All intercompany balances and revenue and expenses have been eliminated on consolidation.

[C] USE OF ESTIMATES

The preparation of consolidated financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, including contingencies, at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results may differ from those estimates. Major areas requiring use of estimates by management are those that require reporting of financial assets and financial liabilities at fair value.

[D] SIGNIFICANT ACCOUNTING POLICIES

Revenue recognition

The Company earns revenue from placement, securitization and servicing activities related to its mortgage business. The majority of originated mortgages are sold to institutional investors through the placement of mortgages or funded through securitization conduits. The Company retains servicing rights on substantially all of the mortgages it originates, providing the Company with servicing fees.

Interest revenue and expense from mortgages pledged under securitization.

The Company enters into securitization transactions to fund a portion of its originated mortgages. Upon transfer of these mortgages to securitization vehicles, the Company receives cash proceeds from the transaction. These proceeds are accounted for as debt related to securitized mortgages and the Company continues to hold the mortgages on its consolidated statements of financial position, unless:

[i] substantially all of the risks and rewards associated with the financial instruments have been transferred, in which case the assets are derecognized in full; or

[ii] a significant portion, but not all, of the risks and rewards have been transferred. The asset is derecognized entirely if the transferee has the ability to sell the financial asset; otherwise the asset continues to be recognized to the extent of the Company's continuing involvement.

Where [i] or [ii] above applies to a fully proportionate share of all or specifically identified cash flows, the relevant accounting treatment is applied to that proportion of the mortgage.

For securitized mortgages that do not meet the criteria for derecognition, no gain or loss is recognized at the time of the transaction. Instead, net interest income is recognized over the term of the mortgages. Interest revenue – securitized mortgages represents interest portion of mortgage payments received and accrued by borrowers and is net of the amortization of capitalized origination costs. Interest expense – securitized mortgages represents the costs to finance these mortgages, net of the amortization of debt discounts and premiums.

Capitalized origination fees and debt discounts or premiums are amortized on an effective yield basis over the term of the related mortgages or debt.

Derecognition

A financial asset is derecognized when:

- The right to receive cash flows from the asset has expired; or
- The Company has transferred its rights to receive cash flows from the assets or has assumed an obligation to pay the cash flows, received in full without material delay to a third party under a "pass-through" arrangement; and either [a] the Company has transferred substantially all the risks and rewards of the asset or [b] the Company has neither transferred nor retained substantially all of the risks and rewards of the asset, but has transferred control of the asset.

When the Company has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all of the risks and rewards of the asset nor transferred control of the asset, the asset is recognized to the extent of the Company's continuing involvement in the asset. In that case, the Company also recognizes an associated liability.

Placement fees and deferred placement fees receivable

The Company enters into placement agreements with institutional investors to purchase the mortgages it originates. When mortgages are placed with institutional investors, the Company transfers the contractual right to receive mortgage cash flows to the investors. Because it has transferred substantially all the risks and rewards of these mortgages, it derecognizes these assets. The Company retains a residual interest representing the rights and obligations associated with servicing the mortgages. Placement fees are earned by the Company for its origination and underwriting activities on a completed transaction basis when the mortgage is funded. Amounts immediately collected or collectible in excess of the mortgage principal are recognized as placement fees. When placement fees and associated servicing fees are earned over the term of the related mortgages, the Company determines the present value of the future stream of placement fees and records a gain on deferred placement fees and a deferred placement fees receivable. Since quoted prices are generally not available for retained interests, the Company estimates values based on the net present value of future expected cash flows, calculated using management's best estimates of key assumptions related to expected prepayment rates and discount rates commensurate with the risks involved.

Mortgage servicing income

The Company services substantially all of the mortgages that it originates whether the mortgage is placed with an institutional investor or transferred to a securitization vehicle. In addition, mortgages are serviced on behalf of third-party institutional investors and securitization structures. For all mortgages administered for investors or third parties, the Company recognizes servicing income when services are rendered. For mortgages placed under deferred placement arrangements, the Company retains the rights and obligations to service the mortgages. The deferred placement fees receivable is the present value of the excess retained cash flows over normal servicing fee rates and is reported as deferred placement revenue at the time of placement. Servicing income related to mortgages placed with institutional investors is recognized in income over the life of the servicing obligation as payments are received from mortgagors. Interest income earned by the Company from holding cash in trust related to servicing activities is classified as mortgage servicing income. The amortization of any servicing liabilities is also recorded as mortgage servicing income.

The Company provides underwriting and fulfillment processing services for mortgages originated by a large Canadian bank through its mortgage broker distribution channel. The Company recognizes servicing income when the services are rendered and the underwritten mortgages are funded.

Mortgage investment income

The Company earns interest income from its interest-bearing assets including deferred placement fees receivable, mortgage and loan investments and mortgages accumulated for sale or securitization. Mortgage investment income is recognized on an accrual basis.

Brokerage fees

Brokerage fees are primarily fees paid to external mortgage brokers. Brokerage fees relating to the mortgages recorded at fair value are expensed as incurred, and those relating to mortgages recorded at amortized cost are deferred and amortized over the term of the mortgages.

Financial assets and financial liabilities

The Company classifies its financial assets as either at FVTPL or loans and receivables. Financial liabilities are classified as either at FVTPL or at amortized cost. Management determines the classification of financial assets and financial liabilities at initial recognition.

Financial assets and financial liabilities at FVTPL

Financial instruments are classified in this category if they are held for trading or if they are designated by management as FVTPL at inception.

Financial instruments are classified as FVTPL if they are acquired principally for the purpose of selling in the short term. Financial assets and financial liabilities may be designated at FVTPL when:

[i] the designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities or recognizing the gains and losses on them on a different basis; or

[ii] a group of financial assets and/or financial liabilities is managed and its performance evaluated on a fair value basis.

The Company has elected to measure certain of its assets at FVTPL. The most significant of these assets include a portion of mortgages pledged under securitization and funded with ABCP related debt, certain mortgages funded with MBS debt, deferred placement fees receivable, and mortgages held by the Trust. The mortgages funded with MBS debt were previously funded by ABCP debt and as such have retained their classification as FVTPL [together with other mortgages measured at fair value in mortgages pledged under securitization, "FVTPL mortgages"]. For the portion of mortgages pledged under securitization and funded with ABCP related debt, the Company has entered into swaps to convert the mortgages from fixed rate to floating rate in order to match the mortgages with the 30 day floating rate funding provided by the ABCP notes. The swaps are derivatives and are required by IFRS to be accounted for at fair value. This value can change significantly with the passage of time as the interest rate environment changes. In order to avoid a significant accounting mismatch, the Company has measured the swapped mortgages at fair value as well so that the asset and related swap liability values will move inversely as interest rates change. The cash flows related to deferred placement fees receivable are typically received over five-to-ten-year terms. These cash flows are subject to prepayment volatility as the mortgages underlying the deferred placement fees receivable can experience unscheduled prepayments. As well, the Company pledges these assets under its bank credit facility. Accordingly, the Company asserts that it manages these assets on a fair value basis.

Financial assets and financial liabilities at FVTPL are initially recognized at fair value. Subsequent gains (losses) arising from changes in fair value are recognized directly in realized and unrealized losses on financial instruments in the consolidated statements of comprehensive income.

Held-for-trading non-derivative financial assets can only be transferred out of the held at FVTPL category in the following circumstances: to the available-for-sale category, where, in rare circumstances, they are no longer held for the purpose of selling or repurchasing in the near term; or to the loans and receivables category, where they are no longer held for the purpose of selling or repurchasing in the near term and they would have met the definition of a loan and receivable at the date of reclassification and the Company has the intent and ability to hold the assets for the foreseeable future or until maturity.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and it is expected that substantially all of the initial investment will be recovered, other than in the case of credit deterioration.

Loans and receivables are initially recognized at cost, including direct and incremental transaction costs. They are subsequently valued at amortized cost.

Derivative financial instruments

Derivatives are categorized as trading unless they are designated as hedging instruments. Derivative contracts are initially recognized at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at their fair value with the changes in fair value recognized in income as they occur. Positive values are recorded as assets in accounts receivable and sundry and negative values are recorded as liabilities in accounts payable and accrued liabilities.

The Company enters into interest rate swaps primarily to manage its interest rate exposures associated with funding fixed-rate mortgages with floating rate debt. These contracts are negotiated over-the-counter. Interest rate swaps require the periodic exchange of payments without the exchange of the notional principal amount on which the payments are based. The Company's policy is not to utilize derivative financial instruments for trading or speculative purposes.

Mortgages pledged under securitization

Mortgages pledged under securitization are mortgages that the Company has originated and funded with debt raised through the securitization markets. The Company has a continuous involvement in these mortgages, including the right to receive future cash flows arising from these mortgages. Mortgages pledged under securitization [except for mortgages designated as FVTPL] have been classified as loans and receivables and are measured at their amortized cost using the effective yield method. Origination costs, such as brokerage fees and bulk insurance premiums that are directly attributable to the acquisition of such assets, are deferred and amortized over the term of the mortgages on an effective yield basis. Certain mortgages [primarily those funded under bank-sponsored ABCP programs] are classified as FVTPL and recorded at fair value.

Debt related to securitized and participation mortgages

Debt related to securitized mortgages represents obligations related to the financing of mortgages pledged under securitization. This debt is measured at its amortized cost using the effective yield method. Any discount/premium and issuance costs on raising these debts that is directly attributable to obtaining such liabilities is deferred and amortized over the term of the debt obligations.

Debt related to participation mortgages represents obligations related to the financing of a portion of commercial mortgages included in mortgage and loan investments. These mortgages are subject to participation agreements with other financial institutions such that the Company's investment is subordinate to the other institutions' investment. The Company has retained various rights to the mortgages and a proportionately larger share of the interest earned on these mortgages, such that the full mortgage has been recorded on the Company's consolidated statements of financial position with an offsetting debt. This debt is recorded at face value and measured at its amortized cost.

Mortgages accumulated for sale or securitization

Mortgages accumulated for sale are mortgages funded for the purpose of placing with investors and are classified as FVTPL and are recorded at fair value. These mortgages are held for terms usually not exceeding 90 days.

Mortgages accumulated for securitization are mortgages funded pending securitization in the Company's various programs and are classified as loans and receivables. These mortgages are recorded at amortized cost.

Securities sold short and securities purchased under resale agreements

Securities sold short consist typically of the short sale of government of Canada bonds. Bonds purchased under resale agreements consist of the purchase of a bond with the commitment from the Company to resell the bond to the original seller at a specified price. The Company uses the combination of bonds sold short and bonds purchased under resale agreements to economically hedge its mortgage commitments and the portion of funded mortgages that it intends to securitize in subsequent periods.

Bonds sold short are classified as FVTPL and are recorded at fair value. The effective yield payable on bonds sold short is recorded as hedge expense in other operating expenses. Bonds purchased under resale agreements are carried at cost plus accrued interest, which approximates their market value. The difference between the cost of the purchase and the predetermined proceeds to be received on a resale agreement is recorded over the term of the hedged mortgages as an offset to hedge expense. Transactions are recorded on a settlement date basis.

Mortgage and loan investments

Mortgage and loan investments are classified as loans and receivables, except for mortgages held by the Trust which are measured at FVTPL. Mortgages and loan investments are classified as loans and receivable, and are recognized as being impaired when the Company is no longer reasonably assured of the timely collection of the full amount of principal and interest. An allowance for such loan losses is established for mortgages and loans that are known to be uncollectible. When management considers there to be no probability of collection, the investments are written off.

Intangible assets

Intangible assets consist of broker relationships which arose in connection with the Initial Public Offering ["IPO"] in 2006. Intangible assets are subject to annual impairment review if there are events or changes in circumstances that indicate the carrying amount may not be recoverable.

Intangible assets with finite useful lives are amortized on a straight line basis over their estimated useful lives. The broker relationships are amortized on a straight-line basis over 10 years.

The intangible assets were fully amortized in June 2016.

Property, plant and equipment

Property, plant and equipment are recorded at cost, less accumulated amortization, at the following annual rates and bases:

Computer equipment	30% declining balance
Office equipment	20% declining balance
Leasehold improvements	straight-line over the term of the lease
Computer software	30% declining balance except for a computer license, which is straight-line over 10 years

Property, plant and equipment are subject to an impairment review if there are events or changes in circumstances that indicate the carrying amount may not be recoverable.

Goodwill

Goodwill represents the price paid for the Corporation's business in excess of the fair value of the net tangible assets and identifiable intangible assets acquired in connection with the IPO. Goodwill is reviewed annually for impairment or more frequently when an event or change in circumstances indicates that the asset might be impaired.

Purchased mortgage servicing rights

The Company purchased the rights to service mortgages from third parties. Purchased mortgage servicing rights are initially recorded at cost and charged to income over the life of the underlying mortgage servicing obligation. The fair value of such rights is determined on a periodic basis to assess the continued recoverability of the unamortized cost in relation to estimated future cash flows associated with the underlying serviced assets. Any loss arising from an excess of the unamortized cost over the fair value is immediately recorded as a charge to income. The purchased mortgage servicing rights were fully amortized in June 2017.

Restricted cash

Restricted cash represents principal and interest collected on mortgages pledged under securitization that is held in trust until the repayment of debt related to these mortgages is made in a subsequent period.

Bank indebtedness

Bank indebtedness consists of bank indebtedness net of cash balances with banks.

Cash held as collateral for securitization

Cash held as collateral for securitization represents cash-based credit enhancements held by various securitization vehicles, including FNFC Trust and a Canadian Trust Company acting as the title custodian for the Company's NHA MBS program.

Servicing liability

The Company places mortgages with third-party institutional clients, and retains the rights and obligations to service these mortgages. When the service related fees are paid upfront by a third party, the Company records a servicing liability for the additional future servicing cost as compared to the market rate, and a corresponding reduction of placement fees at the time of sales. The Company determines the present value of servicing liability based on the net present value of the additional future expected cost of servicing these mortgages. This is similar to the method the Company uses to calculate deferred placement fees. Since quoted prices are generally not available for retained interests, the Company estimates its value based on the net present value of future expected cash flows, calculated using management's best estimates of key assumptions related to expected prepayment rates and discount rates commensurate with the risks involved. The Company earns the related servicing fees over the term of the mortgages on an effective yield basis.

Income taxes

The Company accounts for income taxes in accordance with the liability method of tax allocation. Under this method, the provision for income taxes is calculated based on income tax laws and income tax rates substantively enacted as at the dates of the consolidated statements of financial position. The income tax provision consists of current income taxes and deferred income taxes. Current and deferred taxes relating to items in the Company's equity are recorded directly against equity.

Current income taxes are amounts expected to be payable or recoverable as the result of operations in the current year and any adjustment to tax payable/recoverable recorded in previous years.

Deferred income taxes arise on temporary differences between the carrying amounts of assets and liabilities on the consolidated statements of financial position and their tax bases. Deferred tax liabilities are generally recognized for all taxable temporary differences and deferred tax assets are recognized to the extent that future realization of the tax benefit is probable. Deferred taxes are calculated using the tax rates expected to apply in the periods in which the assets will be realized or the liabilities settled. Deferred tax assets and liabilities are offset when they arise in the same tax reporting group and relate to income taxes levied by the same taxation authority, and when a legal right to offset exists in the entity.

Earnings per common share

The Company presents earnings per share ["EPS"] amounts for its common shares. EPS is calculated by dividing the net earnings attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the year.

NOTE 3. MORTGAGES PLEDGED UNDER SECURITIZATION

The Company securitizes residential and commercial mortgages in order to raise debt to fund these mortgages. Most of these securitizations consist of the transfer of fixed and floating rate mortgages into securitization programs, such as ABCP, NHA MBS, and the Canada Mortgage Bonds ["CMB"] program. In these securitizations, the Company transfers the assets to SPEs for cash, and incurs interest-bearing obligations typically matched to the term of the mortgages. These securitizations do not qualify for derecognition, although the SPEs and other securitization vehicles have no recourse to the Company's other assets for failure of the mortgages to make payments when due.

As part of the ABCP transactions, the Company provides cash collateral for credit enhancement purposes as required by the rating agencies. The Company's credit exposure to securitized mortgages is generally limited to this cash collateral. The principal and interest payments on the securitized mortgages are paid by the Company to the SPEs monthly over the term of the mortgages. The full amount of the cash collateral is recorded as an asset and the Company anticipates full recovery of these amounts. NHA MBS securitizations may also require cash collateral in some circumstances. As at December 31, 2017, the cash held as collateral for securitization was $66,413 [2016 – $22,877].

The following table compares the carrying amount of mortgages pledged under securitization and the associated debt:

2017	Carrying amount of securitized mortgages ($)	Carrying amount of associated liabilities ($)
Securitized mortgages at face value	**$27,427,239**	**$27,914,097**
Mark-to-market adjustment	**(1,683)**	**—**
Capitalized origination costs	**141,121**	**—**
Debt discounts	**—**	**(80,340)**
	$27,566,677	**$27,833,757**
Add		
Principal portion of payments held in restricted cash	**514,793**	**—**
Participation debt	**—**	**323**
	$28,081,470	**$27,834,080**

2016	Carrying amount of securitized mortgages ($)	Carrying amount of associated liabilities ($)
Securitized mortgages at face value	$25,946,355	$26,565,848
Mark-to-market adjustment	21,369	—
Capitalized origination costs	138,940	—
Debt discounts	—	(57,765)
	$26,106,664	$26,508,083
Add		
Principal portion of payments held in restricted cash	636,763	—
Participation debt	—	6,098
	$26,743,427	$26,514,181

The principal portion of payments held in restricted cash represents payments on account of mortgages pledged under securitization which has been received at year end but has not yet been applied to reduce the associated debt. This cash is applied to pay down the debt in the month subsequent to collection. In order to compare the components of mortgages pledged under securitization to securitization debt, this amount is added to the carrying value of mortgages pledged under securitization in the above table.

The changes in capitalized origination costs for the years ended December 31 are summarized as follows:

	2017	2016
Opening balance, January 1	**$138,940**	$137,965
Add: new origination costs capitalized in the year	**70,716**	65,682
Less: amortization in the year	**(68,535)**	(64,707)
Ending balance, December 31	**$141,121**	$138,940

During the year ended December 31, 2017, the Company invested in mortgages that were transferred into the securitization vehicles with principal balances as of December 31, 2017 of $5,928,283 [2016 – $6,406,495].

The contractual maturity profile of the mortgages pledged under securitization programs is summarized as follows:

2018	$3,618,637
2019	4,514,865
2020	4,205,660
2021	6,072,827
2022 and thereafter	9,015,250
	$27,427,239

Mortgages pledged under securitization have been classified as loans and receivables, except for approximately $3.0 billion [2016 – $2.7 billon] of mortgages measured at FVTPL. The mortgages classified as loans and receivables are carried at par plus unamortized origination costs.

The following table summarizes the insured mortgages pledged under securitization that are past due as at December 31:

	2017	2016
Arrears days		
31 to 60	**$35,652**	$51,524
61 to 90	**5,841**	40,508
Greater than 90	**28,707**	43,205
	$70,200	$135,237

All the mortgages listed above are insured, except for one mortgage which is uninsured and has a principal balance of $289 as at December 31, 2017 [2016 – nil]. The Company's exposure to credit loss for the entire portfolio is limited to uninsured mortgages with principal balances totalling $1,106,796 [2016 – $125,092], before consideration of the value of underlying collateral. All such mortgages are conventional prime single-family mortgages (80% or less loan to value and verified borrower income). Accordingly, the Company considers there to be a very small risk of loss, and no provision for credit loss has been recorded related to these mortgages.

The Company uses various assumptions to value FVTPL mortgages, which are set out in the tables below, including the rate of unscheduled prepayment. Accordingly, FVTPL mortgages are subject to measurement uncertainty. The effect of variations between actual experience and assumptions will be recorded in future statements of comprehensive income. Key economic weighted average assumptions and the sensitivities of the current carrying values to immediate 10% and 20% adverse changes in those assumptions as at December 31 are as follows:

	2017	
	Commercial mortgages	**Residential mortgages**
FVTPL mortgages	**$53,879**	**$2,932,218**
Average life (in months) [1]	**31**	**27**
Prepayment speed assumption (annual rate)	**0.1%**	**10.9%**
Impact on fair value of 10% adverse change	**—**	**216**
Impact on fair value of 20% adverse change	**—**	**428**
Discount rate (annual rate)	**2.7%**	**2.6%**
Impact on fair value of 10% adverse change	**356**	**13,930**
Impact on fair value of 20% adverse change	**707**	**27,717**

	2016	
	Commercial mortgages	**Residential mortgages**
FVTPL mortgages	$84,777	$2,578,979
Average life (in months) [1]	28	21
Prepayment speed assumption (annual rate)	0.1%	10.7%
Impact on fair value of 10% adverse change	—	192
Impact on fair value of 20% adverse change	—	383
Discount rate (annual rate)	2.0%	1.8%
Impact on fair value of 10% adverse change	402	7,152
Impact on fair value of 20% adverse change	799	14,262

[1] The weighted average life of prepayable assets in periods is calculated by multiplying the principal collections expected in each future period by the number of periods until that future period, summing those products, and dividing the sum by the initial principal balance.

These sensitivities are hypothetical and should be used with caution. As the figures indicate, changes in carrying value based on a 10% or 20% variation in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. Also, in these tables, the effect of a variation in a particular assumption on the fair value is calculated without changing any other assumption; in reality, changes in one factor may result in changes in another [for example, increases in market interest rates may result in lower prepayments], which might magnify or counteract the sensitivities.

NOTE 4. DEFERRED PLACEMENT FEES RECEIVABLE

The Company enters into transactions with institutional investors to sell primarily fixed-rate mortgages in which placement fees are received over time as well as at the time of the mortgage placement. These mortgages are derecognized when substantially all of the risks and rewards of ownership are transferred and the Company has minimal exposure to the variability of future cash flows from these mortgages. The investors have no recourse to the Company's other assets for failure of mortgagors to pay when due.

During the year ended December 31, 2017, $2,005,667 [2016 – $2,213,576] of mortgages were placed with institutional investors, which created gains on deferred placement fees of $10,020 [2016 – $16,332]. Cash receipts on deferred placement fees receivable for the year ended December 31, 2017 were $12,772 [2016 – $11,014].

The Company uses various assumptions to value the deferred placement fees receivable, which are set out in the tables below, including the rate of unscheduled prepayments. Accordingly, the deferred placement fees receivable are subject to measurement uncertainty. As at December 31, 2017, the fair value of deferred placement fees receivable is $41,273 [2016 – $43,933]. An assumption of no credit losses was used, commensurate with the credit quality of the investors. An assumption of no prepayment for the commercial segment was used, as borrowers cannot refinance for financial advantage without paying the Company a fee commensurate with its investment in the mortgage. The effect of variations between actual experience and assumptions will be recorded in future statements of comprehensive income. Key economic weighted average assumptions and the sensitivity of the current carrying value of residual cash flows to immediate 10% and 20% adverse changes in those assumptions are summarized as at December 31 as follows:

	2017	2016
Average life (in months) [1]	**60**	63
Residual cash flows discount rate (annual rate)	**4.8%**	3.9%
Impact on fair value of 10% adverse change	**$490**	$435
Impact on fair value of 20% adverse change	**$970**	$863

[1] The weighted average life of prepayable assets in periods is calculated by multiplying the principal collections expected in each future period by the number of periods until that future period, summing those products, and dividing the sum by the initial principal balance.

These sensitivities are hypothetical and should be used with caution. As the figures indicate, changes in carrying value based on a 10% or 20% variation in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear.

The Company estimates that the expected cash flows from the receipt of payments on the deferred placement fees receivable will be as follows:

2018	$12,241
2019	9,783
2020	7,625
2021	5,753
2022 and thereafter	11,444
	$46,846

NOTE 5. MORTGAGES ACCUMULATED FOR SALE OR SECURITIZATION

Mortgages accumulated for sale or securitization consist of mortgages the Company has originated for its own securitization programs together with mortgages funded for placement with institutional investors.

Mortgages originated for the Company's own securitization programs are classified as loans and receivables and are recorded at amortized cost. Mortgages funded for placement with institutional investors are designated as FVTPL, and are recorded at fair value. The fair values of mortgages classified as FVTPL approximate their carrying values due to their short term nature. The following table summarizes the components of mortgages according to their classification:

	2017	2016
Mortgages accumulated for securitization	**$1,770,275**	$1,797,321
Mortgages accumulated for sale	**19,490**	40,595
	$1,789,765	$1,837,916

The Company's exposure to credit loss is limited to $569,571 [2016 – $345,179] of principal balances of uninsured mortgages within mortgages accumulated for securitization, before consideration of the value of underlying collateral. These are conventional prime single-family mortgages similar to the mortgages described in note 3. For the same rationale, the Company has not recorded any provision for credit loss related to these mortgages.

NOTE 6. MORTGAGE AND LOAN INVESTMENTS

As at December 31, 2017, mortgage and loan investments consist primarily of commercial first and second mortgages held for various terms, the majority of which mature within one year.

Mortgage and loan investments consist of the following:

	2017	2016
Mortgage loans, classified as loans and receivables	**$379,713**	$213,372
Mortgage loans, designated as FVTPL	—	41,858
	$379,713	$255,230

Mortgage and loan investments classified as loans and receivables are carried at outstanding principal balances adjusted for unamortized premiums or discounts and are net of specific provisions for credit losses, if any.

The following table discloses the composition of the Company's portfolio of mortgage and loan investments by geographic region as at December 31, 2017:

Province/Territory	Portfolio balance	Percentage of portfolio
Alberta	**$10,785**	2.84%
British Columbia	**56,237**	14.81
Manitoba	**37,510**	9.88
New Brunswick	**5,625**	1.48
Newfoundland and Labrador	**2,936**	0.77
Nova Scotia	**28,186**	7.42
Nunavut	**162**	0.04
Ontario	**199,044**	52.42
Quebec	**38,371**	10.11
Saskatchewan	**211**	0.06
Yukon	**646**	0.17
	$379,713	100.00%

The following table discloses the mortgages that are past due as at December 31:

	2017	2016
Arrears days		
31 to 60	$13,433	$4,932
61 to 90	—	61
Greater than 90	43,974	48,172
	$57,407	$53.165

Within mortgage and loan investments, the total of uninsured mortgages in arrears is approximately $49,693 [2016 – $44,231]. Four of these mortgages are non-performing and have principal balances totalling $44,438 as at December 31, 2017 [2016 – three mortgages, totalling $43,286]. The Company has stopped accruing interest on these mortgages, and has provided allowances for potential credit losses of $13,231 as at December 31, 2017 [2016 – $10,041]. The Company acknowledges that there is a higher risk of credit losses on this portfolio than the other mortgage portfolios on its consolidated statements of financial position. The Company believes it has adequately provided for such losses in the allowance for potential credit loss disclosed above and considers there to be a lower risk of credit losses on the performing mortgages, such that credit losses have been recorded only on account of non-performing mortgages.

The maturity profile in the table below is based on the earlier of contractual renewal or maturity dates.

	2017						2016
	2018	2019	2020	2021	2022 and thereafter	Book value	Book value
Residential	$13,802	$593	$262	$8,462	$11,701	$34,820	$30,233
Commercial	259,267	55,740	24,838	—	5,048	344,893	224,997
	$273,069	$56,333	$25,100	$8,462	$16,749	$379,713	$255,230

Interest income for the year was $18,610 [2016 – $15,390] and is included in mortgage investment income on the consolidated statements of comprehensive income.

NOTE 7. OTHER ASSETS

The components of other assets are as follows as at December 31:

	2017	2016
Property, plant and equipment, net	**$11,670**	$12,556
Goodwill	**29,776**	29,776
Purchased mortgage servicing rights	**—**	664
	$41,446	$42,996

Purchased mortgage servicing rights were fully amortized during the 2017 year.

For the purpose of testing goodwill for impairment, the cash generating unit is considered to be the Corporation as a whole, since the goodwill relates to the excess purchase price paid for the Corporation's business in connection with the IPO. The recoverable amount of the Corporation is calculated by reference to the Corporation's market capitalization, mortgages under administration, origination volume, and profitability. These factors indicate that the Corporation's recoverable amount exceeds the carrying value of its net assets and accordingly, goodwill is not impaired.

NOTE 8. MORTGAGES UNDER ADMINISTRATION

As at December 31, 2017, the Company had mortgages under administration of $101,589,153 [2016 – $99,391,490], including mortgages held on the Company's consolidated statements of financial position. Mortgages under administration are serviced for financial institutions such as banks, insurance companies, pension funds, mutual funds, trust companies, credit unions and securitization vehicles. As at December 31, 2017, the Company administered 301,492 mortgages [2016 – 303,389] for 103 institutional investors [2016 – 102] with an average remaining term to maturity of 41 months [2016 – 41 months].

Mortgages under administration are serviced as follows:

	2017	2016
Institutional investors	**$59,601,263**	$55,062,554
Mortgages accumulated for sale or securitization and mortgage and loan investments	**2,190,393**	2,099,598
Deferred placement investors	**11,125,228**	10,417,963
Mortgages pledged under securitization	**27,427,239**	25,946,355
CMBS conduits	**1,245,030**	1,865,020
	$101,589,153	$99,391,490

The Company's exposure to credit loss is limited to mortgage and loan investments as described in note 6, securitized mortgages as described in note 3 and uninsured mortgages held in mortgages accumulated for securitization as described in note 5. As at December 31, 2017, the Company has included in accounts receivable and sundry $17,799 [2016 – $14,618] of uninsured non performing mortgages [net of provisions for credit losses] and outstanding claims from mortgage default insurers. The Company had a net recovery of $1,233 during the year ended December 31, 2017 [2016 – losses of $1].

The Company maintains trust accounts on behalf of the investors it represents. The Company also holds municipal tax funds in escrow for mortgagors. Since the Company does not hold a beneficial interest in these funds, they are not presented on the consolidated statements of financial position. The aggregate of these accounts as at December 31, 2017 was $1,739,200 [2016 – $798,876].

NOTE 9. BANK INDEBTEDNESS

Bank indebtedness includes a revolving credit facility of $1,060,000 [2016 – $1,000,000] maturing in March 2022, of which $656,828 [2016 – $625,950] was drawn as at December 31, 2017 and against which the following have been pledged as collateral:

[a] a general security agreement over all assets, other than real property, of the Company; and

[b] a general assignment of all mortgages owned by the Company.

The credit facility bears a variable rate of interest based on prime and bankers' acceptance rates.

NOTE 10. DEBT RELATED TO SECURITIZED AND PARTICIPATION MORTGAGES

Debt related to securitized mortgages represents the funding for mortgages pledged under the NHA-MBS, CMB and ABCP programs. As at December 31, 2017, debt related to securitized mortgages was $27,833,757 [2016 – $26,508,083], net of unamortized discounts of $80,340 [2016 – $57,765]. A comparison of the carrying amounts of the pledged mortgages and the related debt is summarized in note 3.

As at December 31, 2017, debt related to participation mortgages was $323 [2016 – $6,098].

Debt related to securitized and participation mortgages is reduced on a monthly basis when the principal payments received from the mortgages are applied. Debt discounts and premiums are amortized over the term of each debt on an effective yield basis. Debt related to securitization mortgages had a similar contractual maturity profile as the associated mortgages in mortgages pledged under securitization.

NOTE 11. SWAP CONTRACTS

Swaps are over-the-counter contracts in which two counterparties exchange a series of cash flows based on agreed upon rates to a notional amount. The Company uses interest rate swaps to manage interest rate exposure relating to variability of interest earned on a portion of mortgages pledged under securitization held on the consolidated statements of financial position. The swap agreements that the Company enters into are interest rate swaps where two counterparties exchange a series of payments based on different interest rates applied to a notional amount in a single currency.

The following tables present, by remaining term to maturity, the notional amounts and fair values of the swap contracts that do not qualify for hedge accounting as at December 31, 2017 and 2016:

2017

	Less than 3 years	3 to 5 years	6 to 10 years	Total notional amount	Fair value
Interest rate swap contracts	**$1,138,520**	**$3,139,547**	**$10,370**	**$4,288,437**	**$57,334**

2016

	Less than 3 years	3 to 5 years	6 to 10 years	Total notional amount	Fair value
Interest rate swap contracts	$1,115,136	$3,009,611	$2,172	$4,126,919	$5,353

Positive fair values of the interest rate swap contracts are included in accounts receivable and sundry and negative fair values are included in accounts payable and accrued liabilities on the consolidated statements of financial position.

NOTE 12. SENIOR UNSECURED NOTES

On April 9, 2015, the Company issued $175 million of senior unsecured notes for a five-year term maturing on April 9, 2020. The notes bear interest at 4.01% payable in equal semi-annual payments commencing October 9, 2015. The net proceeds of the issuance [$174.3 million, net of financing fees] have been invested in FNFLP. The Company used the proceeds from the issuance to fund the maturity of $175 million of debentures on May 7, 2015.

NOTE 13. COMMITMENTS, GUARANTEES AND CONTINGENCIES

As at December 31, 2017, the Company has the following operating lease commitments for its office premises:

2018	$6,697
2019	6,955
2020	6,363
2021	4,985
2022 and thereafter	473
	$25,473

Outstanding commitments for future advances on mortgages with terms of one to 10 years amounted to $1,634,058 as at December 31, 2017 [2016 – $1,172,905]. The commitments generally remain open for a period of up to 90 days. These commitments have credit and interest rate risk profiles similar to those mortgages that are currently under administration. Certain of these commitments have been sold to institutional investors while others will expire before being drawn down. Accordingly, these amounts do not necessarily represent future cash requirements of the Company.

In the normal course of business, the Company enters into a variety of guarantees. Guarantees include contracts where the Company may be required to make payments to a third party, based on changes in the value of an asset or liability that the third party holds. In addition, contracts under which the Company may be required to make payments if a third party fails to perform under the terms of the contract [such as mortgage servicing contracts] are considered guarantees. The Company has determined that the estimated potential loss from these guarantees is insignificant.

NOTE 14. SECURITIES TRANSACTIONS UNDER REPURCHASE AND RESALE AGREEMENTS

The Company's outstanding securities purchased under resale agreements and securities sold under repurchase agreements have a remaining term to maturity of less than three months.

NOTE 15. OBLIGATIONS RELATED TO SECURITIES AND MORTGAGES SOLD UNDER REPURCHASE AGREEMENTS

The Company uses repurchase agreements to fund specific mortgages included in mortgages accumulated for sale or securitization. The current contracts are with financial institutions, are based on bankers' acceptance rates and mature on or before January 31, 2018.

NOTE 16. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

The major components of accounts payable and accrued liabilities are as follows as at December 31:

	2017	**2016**
Accounts payable	**$49,141**	$46,900
Accrued interest on securitization debt	**43,940**	40,833
Servicing liability	**18,876**	17,893
Swap liabilities	**6,124**	16,873
	$118,081	$122,499

Accrued interest on securitization debt is the interest due on securitization related debt due subsequent to year end.

NOTE 17. SHAREHOLDERS' EQUITY

[a] Authorized

Unlimited number of common shares

Unlimited number of cumulative 5-year rate reset preferred shares, Class A Series 1

Unlimited number of cumulative 5-year rate reset preferred shares, Class A Series 2

[b] Capital stock

Balance, December 31, 2017 and 2016

		2017	2016
59,967,429	common shares	**$122,671**	$122,671
4,000,000	preferred shares	**$97,394**	$97,394

[c] Preferred shares

On January 25, 2011, the Company issued 4 million Class A Series 1 Preferred Shares at a price of $25.00 per share for gross proceeds of $100,000 before issue expenses.

Holders of the Class A Series 1 Preferred Shares received a cumulative quarterly fixed dividend yielding 4.65% annually for the initial period ended March 31, 2016. Thereafter, the dividend rate may be reset every five years at a rate equal to the five year Government of Canada yield plus 2.07%, as and when approved by the Board of Directors. On April 1, 2016, the Company reset the dividend rate on the Class A Series 1 shares to 2.79% for a new five year term ending March 31, 2021.

Holders of Class A Series 1 Preferred Shares have the right, at their option, to convert their shares into cumulative, floating rate Class A Preferred Shares, Series 2 ["Series 2 Preferred Shares"], subject to certain conditions, on March 31, 2021 and on March 31 every five years thereafter. Holders of the Series 2 Preferred Shares will be entitled to receive cumulative quarterly floating dividends at a rate equal to the three month Government of Canada treasury bill yield plus 2.07% as and when declared by the Board of Directors.

On April 1, 2016, certain preferred shareholders exercised their right to convert fixed rate Series 1 shares into floating rate Series 2 shares. Subsequent to the conversion, 2,887,147 Series 1 preferred shares and 1,112,853 Series 2 preferred shares were outstanding with a total carrying value of $97,394.

Preferred shares do not have voting rights. The par value per preferred share is $25.

[d] Earnings per share

	2017	2016
Net income and comprehensive income attributable to shareholders	**$208,078**	$199,744
Less: dividends declared on preferred shares	**(2,747)**	(3,213)
Net earnings attributable to common shareholders	**205,331**	196,531
Number of common shares outstanding	**59,967,429**	59,967,429
Basic earnings per common share	**3.42**	3.28

NOTE 18. INCOME TAXES

The major components of deferred tax expense for the years ended December 31 consists of the following:

	2017	2016
Related to origination and reversal of timing differences	**$11,650**	$7,700

The major components of current income tax expense for the years ended December 31 consists of the following:

	2017	2016
Income taxes relating to the current year	**$64,100**	$64,600

The effective income tax rate reported in the consolidated statements of comprehensive income varies from the Canadian tax rate of 26.52% for the year ended December 31, 2017 [2016 – 26.54%] for the following reasons:

	2017	2016
Company's statutory tax rate	**26.52%**	26.54%
Income before income taxes	**$285,402**	$274,129
Income tax at statutory tax rate	**75,689**	72,754
Increase (decrease) resulting from		
Income not subject to tax	**(111)**	(699)
Permanent differences	**291**	277
Differences in current and future tax rates	**(39)**	(89)
Other	**(80)**	57
Income tax expense	**$75,750**	$72,300

The movement in significant components of the Company's deferred tax liabilities and assets for the years ended December 31, 2017 and 2016 are as follows:

	As at January 1, 2017	Recognized in income	As at December 31, 2017
DEFERRED INCOME TAX LIABILITIES			
Deferred placement fees receivable	**$11,660**	**$(714)**	**$10,946**
Capitalized broker fees	**38,015**	**(405)**	**37,610**
Carrying values of mortgages pledged under securitization in excess of tax values	**5,671**	**(6,117)**	**(446)**
Unamortized discount on debt related to securitized mortgages	**15,331**	**5,975**	**21,306**
Unrealized gains on interest rate swaps	**4,787**	**13,079**	**17,866**
Other	**589**	**(512)**	**77**
Total deferred income tax liabilities	**$76,053**	**$11,306**	**$87,359**
DEFERRED INCOME TAX ASSETS			
Intangible assets	**(4,908)**	**347**	**(4,561)**
Servicing liability	**(4,749)**	**(257)**	**(5,006)**
Loan loss reserves not deducted for tax purposes	**(3,296)**	**254**	**(3,042)**
Total deferred income tax assets	**(12,953)**	**344**	**(12,609)**
Net deferred income tax liabilities	**$63,100**	**$11,650**	**$74,750**

	As at January 1, 2016	Recognized in income	As at December 31, 2016
DEFERRED INCOME TAX LIABILITIES			
Deferred placement fees receivable	$10,136	$1,524	$11,660
Capitalized broker fees	36,643	1,372	38,015
Carrying values of mortgages pledged under securitization in excess of tax values	10,601	(4,930)	5,671
Intangible assets	664	(664)	—
Unamortized discount on debt related to securitized mortgages	17,149	(1,818)	15,331
Other	1,174	(585)	589
Total deferred income tax liabilities	$76,367	$(5,101)	$71,266
DEFERRED INCOME TAX ASSETS			
Intangible assets	$(5,282)	$374	$(4,908)
Servicing liability	(5,079)	330	(4,749)
Loan loss reserves not deducted for tax purposes	(1,264)	(2,032)	(3,296)
Gains (losses) on interest rate swaps	(9,329)	14,116	4,787
Share and debenture issuance costs	(13)	13	—
Total deferred income tax assets	(20,967)	12,801	(8,166)
Net deferred income tax liabilities	$55,400	$7,700	$63,100

The calculation of taxable income of the Company is based on estimates and the interpretation of complex tax legislation. In the event that the tax authorities take a different view from management, the Company may be required to change its provision for income taxes or deferred tax balances and the change could be significant.

NOTE 19. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Risk management

The various risks to which the Company is exposed and the Company's policies and processes to measure and manage them individually are set out below:

Interest rate risk

Interest rate risk arises when changes in interest rates will affect the fair value of financial instruments.

The Company uses various strategies to reduce interest rate risk. The Company's risk management objective is to maintain interest rate spreads from the point that a mortgage commitment is issued to the transfer of the mortgage to the related securitization vehicle or sale to an institutional investor. Primary among these strategies is the Company's decision to sell mortgages at the time of commitment, passing on interest rate risk that exists prior to funding to institutional investors. The Company uses synthetic bond forwards [consisting of bonds sold short and bonds purchased under resale agreements] to manage interest rate exposure between the time a mortgage rate is committed to the borrower and the time the mortgage is sold to a securitization vehicle and the underlying cost of funding is set. As interest rates change, the values of these interest rate dependent financial instruments vary inversely with the values of the mortgage contracts. As interest rates increase, a gain will be recorded on the economic hedge which will be offset by the reduced future spread on mortgages pledged under securitization as the mortgage rate committed to the borrower is fixed at the point of commitment.

For single-family mortgages, only a portion of the commitments issued by the Company eventually fund. The Company must assign a probability of funding to each mortgage in the pipeline and estimate how that probability changes as mortgages move through the various stages of the pipeline. The amount that is actually economically hedged is the expected value of the mortgages funding within the future commitment period.

The table below provides the financial impact that an immediate and sustained 100 basis point and 200 basis point increase and decrease in short-term interest rates would have had on the net income of the Company in 2017 and 2016.

	Decrease in interest rate[(1)]		Increase in interest rate	
	2017	**2016**	**2017**	**2016**
100 BASIS POINT SHIFT				
Impact on net income and equity attributable to shareholders	**$1,946**	$2,805	**$(958)**	$(393)
200 BASIS POINT SHIFT				
Impact on net income and equity attributable to shareholders	**$10,875**	$10,948	**$(1,917)**	$(787)

(1) Interest rate is not assumed to decrease below 0%.

Credit risk

Credit risk is the risk of loss associated with a counterparty's inability or unwillingness to fulfill its payment obligations. The Company's credit risk is mainly lending related in the form of mortgage default. The Company uses stringent underwriting criteria and experienced adjudicators to mitigate this risk. The Company's approach to managing credit risk is based on the consistent application of a detailed set of credit policies and prudent arrears management. The Company has addressed credit risk for its own portfolio of mortgages pledged under securitization by focusing on mortgages insured by mortgage default insurers which are substantially supported by the credit of the Canadian government. As at December 31, 2017, 96.0% [2016 – 99.5%] of the pledged mortgages were insured mortgages. In 2017, the Company increased its investment in conventional (uninsured) mortgages as mortgage spreads widened on this product pursuant to mortgage rules announced in 2016. The uninsured mortgages had a weighted average loan to value of 68.3% [2016 – 58.4%]. See details in note 3. The Company's exposure is further mitigated by the relatively short period over which a mortgage is held by the Company prior to securitization.

The maximum credit exposures of the financial assets are their carrying values as reflected on the consolidated statements of financial position. The Company does not have significant concentration of credit risk within any particular geographic region or group of customers.

The Company is at risk that the underlying mortgages default and the servicing cash flows cease. The large portfolio of individual mortgages that underlies these assets is diverse in terms of geographical location, borrower exposure and the underlying type of real estate. This diversity and the priority ranking of the Company's rights mitigate the potential size of any single credit loss.

Securities purchased under resale agreements are transacted with large regulated Canadian institutions such that the risk of credit loss is very remote. Securities transacted are all Government of Canada bonds and, as such, have virtually no risk of credit loss.

Liquidity risk and capital resources

Liquidity risk is the risk that the Company will be unable to meet its financial obligations as they come due.

The Company's liquidity strategy has been to use bank credit to fund working capital requirements and to use cash flow from operations to fund longer-term assets. The Company's credit facilities are typically drawn to fund: [i] mortgages accumulated for sale or securitization, [ii] origination costs associated with mortgages pledged under securitization, [iii] cash held as collateral for securitization, [iv] costs associated with deferred placement fees receivable and [v] mortgage and loan investments. The Company has a credit facility with a syndicate of eleven financial institutions, which provides for a total of $1,060,000 in financing.

The Company finances the majority of its mortgages with debt derived from the securitization markets, primarily NHA MBS, ABCP and CMB. Debt related to NHA-MBS and ABCP securitizations reset monthly such that the receipts of principal on the mortgages are used to pay down the related debt within a 30 day period. Accordingly, these sources of financing amortize at the same rate as the mortgages pledged thereunder, providing an almost perfectly matched asset and liability relationship.

Market risk

Market risk is the risk of loss that may arise from changes in market factors such as interest rates and credit spreads. The level of market risk to which the Company is exposed varies depending on market conditions, expectations of future interest rates and credit spreads.

Customer concentration risk

Placement fees and mortgage servicing income from one Canadian financial institution represent approximately 9.9% [2016 – 8.3%] of the Company's total revenue.

Fair value measurement

The Company uses the following hierarchy for determining and disclosing the fair value of financial instruments recorded at fair value in the consolidated statements of financial position:

Level 1 – quoted market price observed in active markets for identical instruments;

Level 2 – quoted market price observed in active markets for similar instruments or other valuation techniques for which all significant inputs are based on observable market data; and

Level 3 – valuation techniques in which one or more significant inputs are unobservable.

Valuation methods and assumptions

The Company uses valuation techniques to estimate fair values, including reference to third party valuation service providers using proprietary pricing models and internal valuation models such as discounted cash flow analysis. The valuation methods and key assumptions used in determining fair values for the financial assets and financial liabilities are as follows:

[a] FVTPL mortgages in mortgages under securitization and certain mortgage and loan investments

The fair value of these mortgages is determined by discounting projected cash flows using market industry pricing practices. Discount rates used are determined by comparison to similar term loans made to borrowers with similar credit. This methodology will reflect changes in interest rates which have occurred since the mortgages were originated. Impaired mortgages are recorded at net realizable value. Refer to note 3 "Mortgages pledged under securitization" for the key assumptions used and sensitivity analysis.

[b] Deferred placement fees receivable

The fair value of deferred placement fees receivable is determined by internal valuation models using market data inputs, where possible. The fair value is determined by discounting the expected future cash flows related to the placed mortgages at market interest rates. The expected future cash flows are estimated based on certain assumptions which are not supported by observable market data. Refer to note 4 "Deferred placement fees receivable" for the key assumptions used and sensitivity analysis.

[c] Securities sold short

The fair values of securities sold short used by the Company to hedge its interest rate exposure are determined by quoted prices.

[d] Servicing liability

The fair value of the servicing liability is determined by internal valuation models using market data inputs, where possible. The fair value is determined by discounting the additional future expected cost of servicing explicit mortgages at market interest rates. The expected future cash flows are estimated based on certain assumptions which are not supported by observable market data.

[e] Other financial assets and financial liabilities

The fair value of mortgage and loan investments classified as loans and receivables, mortgages accumulated for sale or securitization, cash held as collateral for securitization, restricted cash and bank indebtedness correspond to the respective outstanding amounts due to their short-term maturity profiles.

Carrying value and fair value of selected financial instruments

The fair value of the financial assets and financial liabilities of the Company approximates its carrying value, except for mortgages pledged under securitization, which has a carrying value of $27,566,677 [2016 – $26,106,664] and a fair value of $27,557,542 [2016 – $26,388,372], debt related to securitized and participation mortgages, which has a carrying value of $27,834,080 [2016 – $26,514,181], and a fair value of $27,748,498 [2016 – $26,681,028], and senior unsecured notes, which have a carrying value of $174,693 [December 31, 2016 – $174,556], and a fair value of $176,372 [December 31, 2016 – $174,349]. These fair values are estimated using valuation techniques in which one or more significant inputs are unobservable [Level 3].

The following tables represent the Company's financial instruments measured at fair value on a recurring basis as at December 31:

	2017			
	Level 1	Level 2	Level 3	Total
FINANCIAL ASSETS				
Mortgages accumulated for sale	$—	$19,490	$—	$19,490
FVTPL mortgages	—	—	2,986,097	2,986,097
Deferred placement fees receivable	—	—	41,273	41,273
Interest rate swaps	—	63,689	—	63,689
Total financial assets	$—	$83,179	$3,027,370	$3,110,549
FINANCIAL LIABILITIES				
Securities sold short	—	2,180,253	—	2,180,253
Interest rate swaps	—	6,124	—	6,124
Total financial liabilities	$—	$2,186,377	$—	$2,186,377

	2016			
	Level 1	Level 2	Level 3	Total
FINANCIAL ASSETS				
Mortgages accumulated for sale	$—	$40,595	$—	$40,595
FVTPL mortgages	—	—	2,663,756	2,633,756
Deferred placement fees receivable	—	—	43,933	43,933
Mortgage and loan investments	—	—	41,858	41,858
Interest rate swaps	—	22,227	—	22,227
Total financial assets	$—	$62,822	$2,749,547	$2,812,369
FINANCIAL LIABILITIES				
Securities sold under repurchase agreements and sold short	—	1,308,483	—	1,308,483
Interest rate swaps	—	16,873	—	16,873
Total financial liabilities	$—	$1,325,356	$—	$1,325,356

In estimating the fair value of financial assets and financial liabilities using valuation techniques or pricing models, certain assumptions are used, including those that are not fully supported by observable market prices or rates [Level 3]. The amount of the change in fair value recognized by the Company in net income for the year ended December 31, 2017 that was estimated using a valuation technique based on assumptions that are not fully supported by observable market prices or rates was approximately a loss of $26,342 [2016 – $5,062]. Although the Company's management believes that the estimated fair values are appropriate as at the date of the consolidated statements of financial position, those fair values may differ if other reasonably possible alternative assumptions are used.

Transfers between levels in the fair value hierarchy are deemed to have occurred at the beginning of the period in which the transfer occurred. Transfers between levels can occur as a result of additional or new information regarding valuation inputs and changes in their observability. During the year, the Company did not have any transfers between levels.

The following table presents changes in the fair values, including realized gains of $33,006 [2016 – losses of $2,158] of the Company's financial assets and financial liabilities for the years ended December 31, 2017 and 2016, all of which have been classified as FVTPL.

	2017	2016
FVTPL mortgages	**$(25,312)**	$(4,597)
Deferred placement fees receivable	**(1,030)**	(465)
Securities sold short	**35,468**	10,897
Interest rate swaps	**47,133**	21,915
	$56,259	$27,750

The Company does not have any assets or liabilities that are measured at fair value on a non recurring basis.

Movement in Level 3 financial instruments measured at fair value

The following tables show the movement in Level 3 financial instruments in the fair value hierarchy for the years ended December 31, 2017 and 2016. The Company classifies financial instruments to Level 3 when there is reliance on at least one significant unobservable input in the valuation models.

	Fair value as at January 1, 2017	Investments	Unrealized losses recorded in income	Payment and amortization	Fair value as at December 31, 2017
FINANCIAL ASSETS					
FVTPL mortgages	$2,663,756	$1,612,325	$(25,312)	$(1,264,672)	$2,986,097
Deferred placement fees receivable	43,933	9,452	(1,030)	(11,082)	41,273
Mortgage and loan investments	41,858	10,049	—	(51,907)	—
	$2,749,547	$1,631,826	$(26,342)	$(1,327,661)	$3,027,370

	Fair value as at January 1, 2016	Investments	Unrealized losses recorded in income	Payment and amortization	Fair value as at December 31, 2016
FINANCIAL ASSETS					
FVTPL mortgages	$3,460,924	$4,152,890	$(4,597)	$(4,945,461)	$2,663,756
Deferred placement fees receivable	38,164	15,857	(465)	(9,623)	43,933
Mortgage and loan investments	47,267	17,394	—	(22,803)	41,858
	$3,546,355	$4,186,141	$(5,062)	$(4,977,887)	$2,749,547

Changes in liabilities arising from financing activities

In 2017, the Company adopted the amendments to IAS 7 (Disclosure Initiative) which require entities to provide disclosures about changes in liabilities arising from financing activities, including both changes arising from cash flows as well as non-cash changes.

The following table describes the changes in liabilities arising from financing activities for the year ended December 31, 2017:

	January 1, 2017	Cash flow	Amortization of financing cost	December 31, 2017
FINANCIAL ASSETS				
Bank indebtedness	**$628,522**	**$15,306**	**$—**	**$643,828**
Obligations related to securities and mortgages sold under repurchase agreements	**1,009,572**	**190,563**	**—**	**1,200,135**
Senior unsecured notes	**174,556**	**—**	**137**	**174,693**
Total liabilities from financing activities	**$1,812,650**	**$205,869**	**$137**	**$2,018,656**

NOTE 20. CAPITAL MANAGEMENT

The Company's objective is to maintain a capital base so as to maintain investor, creditor and market confidence and sustain future development of the business. Management defines capital as the Company's equity and retained earnings. The Company has a minimum capital requirement as stipulated by its bank credit facility. The agreement limits the debt under bank indebtedness together with the unsecured notes to four times FNFLP's equity. As at December 31, 2017, the ratio was 1:39:1 [2016 – 1.39:1]. The Company was in compliance with the bank covenant throughout the year.

NOTE 21. EARNINGS BY BUSINESS SEGMENT

The Company operates principally in two business segments, Residential and Commercial. These segments are organized by mortgage type and contain revenue and expenses related to origination, underwriting, securitization and servicing activities. Identifiable assets are those used in the operations of the segments.

	2017		
	Residential	Commercial	Total
REVENUE			
Interest revenue – securitized mortgages	$500,789	$157,994	$658,783
Interest expense – securitized mortgages	(382,604)	(129,335)	(511,939)
Net interest – securitized mortgages	118,185	28,659	146,844
Placement and servicing	237,041	58,409	295,450
Mortgage investment income	47,452	20,824	68,276
Realized and unrealized gains (losses) on financial instruments	41,878	14,381	56,259
	$444,556	$122,273	$566,829
EXPENSES			
Amortization	4,074	1,061	5,135
Interest	37,635	8,793	46,428
Other operating	187,477	42,387	229,864
	229,186	52,241	281,427
Income before income taxes	215,370	70,032	285,402
Identifiable assets	25,653,160	7,093,342	32,746,502
Goodwill	—	—	29,776
Total assets	$25,653,160	$7,093,342	$32,776,278
Capital expenditures	2,974	1,275	4,249

	2016		
	Residential	Commercial	Total
REVENUE			
Interest revenue – securitized mortgages	$488,299	$151,673	$639,972
Interest expense – securitized mortgages	(372,890)	(122,791)	(495,681)
Net interest – securitized mortgages	115,409	28,882	144,291
Placement and servicing	262,352	62,264	324,616
Mortgage investment income	40,111	17,369	57,480
Realized and unrealized gains (losses) on financial instruments	29,267	(1,517)	27,750
	$447,139	$106,998	$554,137
EXPENSES			
Amortization	5,282	1,878	7,160
Interest	31,394	6,881	38,275
Other operating	199,468	35,105	234,573
	236,144	43,864	280,008
Income before income taxes	210,995	63,134	274,129
Identifiable assets	24,718,010	5,646,679	30,364,689
Goodwill	—	—	29,776
Total assets	$24,718,010	$5,646,679	$30,394,465
Capital expenditures	3,243	1,390	4,633

NOTE 22. RELATED PARTY AND OTHER TRANSACTIONS

The Company has servicing contracts in connection with several originated commercial mezzanine mortgages subsequently sold to various entities controlled by a senior executive and shareholder of the Company. The Company services these mortgages during their terms at market commercial servicing rates. During the year, the Company originated $4,897 of new mortgages for the related parties and was awarded servicing related to a $2,176 mortgage which one of the related parties originated. The related parties also funded several progress draws totalling $5,995 on existing mortgages originated by the Company, and assumed a $2,023 mortgage which the Company had originated and serviced for one of its existing arm's-length institutional investors prior to the maturity of the mortgage. Subsequent to the year end, the Company originated a $1,000 new mortgage to one of the related parties. The mortgages, which are administered by the Company, have a balance of $61,034 as at December 31, 2017 [2016 – $69,115]. As at December 31, 2017, three of the mortgages are secured by real estate in which the Company is also a subordinate mortgage lender.

A senior executive and shareholder of the Company has a significant investment in a mortgage default insurance company. In the ordinary course of business, the insurance company provides insurance policies to the Company's borrowers at market rates. In addition, the insurance company has also provided the Company with portfolio insurance at market premiums. The total bulk insurance premium paid in 2017 was $494 [2016 – $2,402], net of third-party investor reimbursement. The insurance company has also engaged the Company to service a portfolio of mortgages at market commercial servicing rates. As at December 31, 2017, the portfolio had a balance of $3,822 [2016 – $3,965].

Management compensation

During the year ended December 31, 2017, the Company paid a total annual compensation of $4,267 [2016 – $3,974] to six senior managers. Senior managers are defined as those persons having authority and responsibility for planning, directing and controlling the activities of the Company.

NOTE 23. FUTURE ACCOUNTING CHANGES

The following accounting pronouncements issued by the IASB, although not yet effective, may have a future impact on the Company:

IFRS 9 – Financial Instruments

In July 2014, the International Accounting Standard Board ["IASB"] issued the final version of IFRS 9 – Financial Instruments, replacing IAS 39 and all previous versions of IFRS 9. This final version of IFRS 9 includes a model for classification and measurement, a single, forward-looking "expected loss" impairment model and a substantially-reformed approach to hedge accounting. Under this standard, financial assets are classified and measured based on the business model in which they are held and the characteristics of their contractual cash flows. The accounting model for financial liabilities is largely unchanged from IAS 39, except for the presentation of the impact of own credit risk on financial liabilities, which will be recognized in other comprehensive income ["OCI"], rather than in profit and loss as under IAS 39. The new general hedge accounting principles under IFRS 9 are aimed to align hedge accounting more closely with risk management. This new standard does not fundamentally change the types of hedging relationships or the requirement to measure and recognize ineffectiveness; however, it is expected to provide more hedging strategies that are used for risk management to qualify for hedge accounting and introduce more judgment to assess the effectiveness of a hedging relationship.

IFRS 9 is effective for annual periods beginning on or after January 1, 2018.

Classifications and Measurement

IFRS 9 requires that all financial assets are to be measured at either at FVTPL, fair value through OCI ["FVOCI"], or amortized cost. Based on its business models, the Company has determined which measurement convention is most appropriate for its mortgage assets as summarized below with a comparison to the classification and measurement under IAS 39:

	IAS 39	IFRS 9
Mortgages accumulated for securitization	Loans and Receivable	Amortized Cost
Mortgages accumulated for sale	FVTPL	FVTPL
Mortgages pledged under securitization	FVTPL or Loan and Receivables	Amortized Cost
Mortgage and loan investments	Loans and Receivable	FVTPL

As at December 31, 2017, the mortgages pledged under securitization which were classified as FVTPL had a mark to market discount to par of $1,683. This amount will be amortized to interest revenue over the term of the related mortgages.

Impairment

IFRS 9 introduces an expected credit loss ["ECL"] model applicable to all debt instrument within financial assets classified as amortized cost or FVOCI and certain off-balance sheet loan commitments. The model has three stages: Stage 1 – the credit risk has not increased significantly since initial recognition such that an allowance for credit loss is recognized and maintained equal to 12 months of expected credit loss: Stage 2 – the credit risk has increased significantly since initial recognition, and the allowance for credit loss is increased to cover full lifetime expected credit loss; and Stage 3 – a financial asset is considered credit-impaired and the allowance for credit loss continues to be the full lifetime expected credit loss, with interest revenue calculated on the carrying amount (net of the allowance for credit loss), rather than the gross carrying value of the financial assets.

The Company's ECL model will be built on an unbiased and probability-weighted method, determined by evaluating a range of possible outcomes. The model will consider the time value of money. Based on the initial analysis, the Company is not expecting a significant impact from the adoption of the impairment loss policy on its consolidated financial statements due to the high proportion of government insured mortgages in its securitized portfolio and the lower historical loss rates on the uninsured mortgages on which the Company lends.

Hedge Accounting

The Company is planning to adopt hedge accounting for certain mortgage commitments and funded mortgages.

For multi-unit residential commercial segment mortgages, the Company will apply cash flow hedge accounting by hedging the anticipated future debt to be arranged on these mortgages. The Company will use short sales of Government of Canada bonds at the time of mortgage commitment as the hedging instrument. When effective hedging is achieved, any gains or losses will be recorded in OCI and amortized into interest expense over the term of the hedged debt.

For residential mortgages accumulated for securitization, the Company will apply fair value hedge accounting to minimize the exposure to changing interest rates by selling short Government of Canada bonds at the time these mortgages are funded. The Company will re-balance and evaluate the hedge effectiveness on an ongoing basis. For an effective hedge, the gains or losses on the hedging instrument will be offset by the losses or gains on the hedged mortgages. At hedge unwind, the changes in the value of the hedging instrument will be adjusted to the carrying value of the hedged mortgages, and amortized into interest revenue over the term of the hedged mortgages. Any changes in the market value of the ineffective hedge will be immediately recorded in the Company's regular income.

The Company will continue to evaluate the impact of IFRS 9 on the Company's consolidated financial statements, but is not expecting any restatement of comprehensive income for prior years.

IFRS 15 – Revenue from Contracts with Customers

In May 2014, the IASB issued IFRS 15 – Revenue from Contracts with Customers, replacing IAS 11 – Construction Contracts, IAS 18 – Revenue, IFRIC 13 – Customer Loyalty Programs, IFRIC 15 – Agreements for the Construction of Real Estate, IFRIC 18 – Transfer of Assets from Customers, and SIC 31 – Revenue – Barter Transactions Involving Advertising Services. The standard contains a single model that applies to contracts with customers and two approaches to recognizing revenue: at a point in time or over time. The model features a contract-based five-step revenue recognition process to determine the nature, amount, timing and uncertainty of revenue and cash flows from the contracts with customers. IFRS 15 is effective for fiscal years beginning on or after January 1, 2018, and can be applied on a retrospective basis or using a modified retrospective approach.

The Company plans to apply the standard on January 1, 2018, using the modified retrospective approach. The main revenue stream that will be affected by IFRS 15 is mortgage servicing revenue, including the ongoing measurement of servicing liabilities. Based on the initial analysis, the Company does not currently expect a material impact of IFRS 15 on its consolidated financial statements, and is not expecting any restatement of comprehensive income for prior years.

IFRS 16 – Leases

In January 2016, the IASB issued IFRS 16 – Leases, replacing IAS 17 – Leases. IFRS 16 requires lessees to recognize assets and liabilities for most leases instead of previous categories of finance leases, which are reported on the balance sheet, or operating leases, which are disclosed only in the notes to the financial statements, under IAS 17. IFRS 16 is effective for annual periods beginning on or after January 1, 2019. Early adoption is permitted for companies that also adopt IFRS 15. The Company is currently assessing the impact of this standard on the Company's consolidated financial statements.

CORPORATE **GOVERNANCE**

First National's Board of Directors and management team fully acknowledge the importance of their duty to serve the long-term interests of shareholders.

Sound corporate governance is fundamental to maintaining the confidence of investors and increasing shareholder value. As such, First National is committed to the highest standards of integrity, transparency, compliance and discipline. These standards define the relationships among all of our stakeholders – Board, management and shareholders – and are the basis for building these values and nurturing a culture of accountability and responsibility across the organization.

POLICIES

The Board supervises and evaluates the management of the Company, oversees matters related to our strategic direction and assesses results relative to our goals and objectives. As such, the Board has adopted several policies that reflect recommended practices in governance and disclosure. These include a Disclosure Policy, a Code of Business Conduct, a Whistleblower Policy and an Insider Trading Policy. These policies follow the corporate governance guidelines of the Canadian Securities Administrators. As a public company, First National's Board continues to update, develop and implement appropriate governance policies and practices as it sees fit.

COMMITTEES

The Board of Directors has established an Audit Committee and a Governance Committee to assist in the efficient functioning of the Company's corporate governance strategy.

AUDIT COMMITTEE

The Audit Committee's responsibilities include:

- Management of the relationship with the external auditor including the oversight and supervision of the audit of the Company's financial statements;
- Oversight and supervision of the quality and integrity of the Company's financial statements, and;
- Oversight and supervision of the adequacy of the Company's internal accounting controls and procedures, as well as its financial reporting practices.

The Audit Committee consists of three independent directors, all of whom are considered financially literate for the purposes of the Canadian Securities Administrators' Multilateral Instrument 52-110 – Audit Committees.

Committee Members

John Brough (Chair), Robert Mitchell and Robert Pearce

GOVERNANCE COMMITTEE

The Governance Committee's responsibilities include:

- Periodically assessing and making recommendations on the Company's approach to governance issues;
- Assisting in the development of governance policies, practices and procedures for approval by the Board of Directors;
- Reviewing conflicts of interest and transactions involving related parties of the Company; and
- Periodically reviewing the composition and effectiveness of the Board of Directors.

The Governance Committee consists of three directors, all of whom are independent for the purposes of the Canadian Securities Administrators' Multilateral Instrument 58-101 – Disclosure of Corporate Governance Practices.

Committee Members

Barbara Palk (Chair), Duncan Jackman and Robert Pearce

BOARD MEMBERS

Collectively, the Board of Directors has extensive experience in mortgage lending, real estate, strategic planning, law and finance. The Board consists of seven members, five of whom are independent.

STEPHEN SMITH

Stephen Smith, one of Canada's leading financial services entrepreneurs, is the Chairman, Chief Executive Officer and Co-Founder of First National Financial Corporation. He has been an innovator in the development and utilization of various securitization techniques to finance mortgage assets as well as a leader in the development and application of information technology in the mortgage industry.

Mr. Smith is Chairman of Canada Guaranty Mortgage Insurance Company, which he owns in partnership with Ontario Teachers' Pension Plan. He is the largest shareholder in Equitable Bank, one of Canada's leading alternative lenders and the country's ninth largest bank. Mr. Smith is a member of the Board of Governors of the Royal Ontario Museum, the Board of Directors of the C. D. Howe Institute, the Empire Life Insurance Company and the Canada Infrastructure Bank. He is also Chairman of Historica Canada, producer of the Heritage Minutes and publisher of The Canadian Encyclopaedia. In 2012, Mr Smith received the Queen Elizabeth II Diamond Jubilee Medal for contributions to Canada.

In 2015, Queen's University announced the naming of The Stephen J.R. Smith School of Business at Queen's University in honour of Mr. Smith and his historic $50-million donation to the school.

Mr. Smith holds a B.Sc. (Hons.) in Electrical Engineering from Queen's University and a M.Sc. in Economics from the London School of Economics.

MORAY TAWSE

Mr. Tawse is Executive Vice President and Secretary of the Corporation, Executive Vice President of First National and co-founder of First National. Mr. Tawse directs the operations of all of First National's commercial mortgage origination activities. With over 30 years of experience in the real estate finance industry, Mr. Tawse is one of Canada's leading experts on commercial real estate and is often called upon to deliver keynote addresses at national real estate symposiums.

JOHN BROUGH

Mr. Brough was President of both Torwest, Inc. and Wittington Properties Limited, real estate development companies, from 1998 to December 31, 2007, upon his retirement. Prior thereto, from 1996 to 1998, Mr. Brough was Executive Vice President and Chief Financial Officer of iSTAR Internet, Inc. Prior thereto, from 1974 to 1996, he held a number of positions with Markborough Properties, Inc., his final position being Senior Vice President and Chief Financial Officer which position he held from 1986 to 1996. Mr. Brough is an executive with over 40 years of experience in the real estate industry. He is currently a director and Chairman of the Audit and Risk Committee of Kinross Gold Corporation, a director and Chairman of the Audit Committee and Lead Director of First National Financial Corporation, and a director and Chairman of the Audit Committee of Canadian Real Estate Investment Trust. He holds a Bachelor of Arts degree (Economics) from the University of Toronto and is a Chartered Professional Accountant and a Chartered Accountant. He is also a graduate of the Institute of Corporate Directors – Director Education Program at the University of Toronto, Rotman School of Management. Mr. Brough is a member of the Institute of Corporate Directors and Chartered Professional Accountants of Ontario and Chartered Professional Accountants of Canada.

DUNCAN JACKMAN

Mr. Jackman is the Chairman, President and Chief Executive Officer of E L Financial Corporation Limited, an investment and insurance holding company and has held similar positions with E-L Financial since 2003. Mr. Jackman is also the Chairman and President of Economic Investment Trust Limited and United Corporations Limited, both closed-end investment corporations, and has acted in a similar capacity with these corporations since 2001. Mr. Jackman sits on a number of public and private company boards. Prior to 2001, Mr. Jackman held a variety of positions including portfolio manager at Cassels Blaikie and investment analyst at RBC Dominion Securities Inc. Mr. Jackman holds a Bachelor of Arts from McGill University.

ROBERT MITCHELL

Mr. Mitchell President has been President of Dixon Mitchell Investment Counsel Inc., a Vancouver-based investment management company since 2000. Prior to that, Mr. Mitchell was Vice President, Investments at Seaboard Life Insurance Company. Mr. Mitchell has an MBA from the University of Western Ontario, a Bachelor of Commerce (Finance) from the University of Calgary, and is a CFA charterholder. Mr. Mitchell sits on the board of Equestrian Canada.

BARBARA PALK

Ms. Palk retired as President of TD Asset Management Inc. in 2010 following a 30 year career in institutional investment and investment management. She currently serves on the Boards of TD Asset Management USA Funds Inc. in New York, Ontario Teachers' Pension Plan and Crombie Real Estate Investment Trust. Her previous board experience includes the Canadian Coalition for Good Governance, whose Governance Committee she chaired, Greenwood College School, the Investment Counselling Association of Canada, the Perimeter Institute, the Shaw Festival, UNICEF Canada and Queen's University, where she was the Chair of the board of Trustees. Ms. Palk is a member of the Institute of Corporate Directors, a Fellow of the Canadian Securities Institute and a CFA charterholder. She holds a Bachelor of Arts (Honours, Economics) degree from Queen's University, and has been named one of Canada's Top 100 Most Powerful Women (2004).

ROBERT PEARCE

Robert Pearce serves on the board of directors of Canada Guaranty Mortgage Insurance Company, First American Payment Systems and CPI Card Group. Mr. Pearce spent 26 years with BMO Bank of Montreal from 1980 to 2006, most recently holding the position of President and Chief Executive Officer, Personal and Commercial Client Group. He also served on the board of directors of MasterCard International from 1998 to 2006 and as Chairman of the Canadian Bankers' Association from 2004 to 2006. Mr. Pearce holds a BA from the University of Victoria and a MBA from the University of British Columbia. Mr. Pearce brings to the board over 30 years of operational and leadership experience in the financial services industry.

STAKEHOLDER INFORMATION

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North Tower, Suite 700
Toronto, Ontario M5J 1V6
Phone: 416.593.1100
Fax: 416.593.1900

ANNUAL MEETING

May 7, 2018, 9:00 a.m. EDT
TMX Broadcast Centre
The Gallery
The Exchange Tower
130 King Street West
Toronto, Ontario

SENIOR EXECUTIVES OF FIRST NATIONAL FINANCIAL LP

Stephen Smith
Co-founder, Chairman and Chief Executive Officer

Moray Tawse
Co-founder and Executive Vice President

Robert Inglis
Chief Financial Officer

Scott McKenzie
Senior Vice President, Residential Mortgages

Jeremy Wedgbury
Senior Vice President, Commercial Mortgages

Lisa White
Senior Vice President, Mortgage Operations

Hilda Wong
Senior Vice President and General Counsel

Jason Ellis
Senior Vice President and Managing Director, Capital Markets

Rick Votano
Vice President, Information Technology

LEGAL COUNSEL

Stikeman Elliott LLP, Toronto, Ontario

AUDITORS

Ernst & Young LLP, Toronto, Ontario

INVESTOR RELATIONS CONTACTS

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Ernie Stapleton
President, Fundamental
ernie@fundamental.ca

INVESTOR RELATIONS WEBSITE

www.firstnational.ca

REGISTRAR AND TRANSFER AGENT

Computershare Investor Services Inc.,
Toronto, Ontario
1.800.564.6253

EXCHANGE LISTING AND SYMBOLS

Common shares: (TSX) FN
Class A Series 1 Preference Shares: (TSX) FN.PR.A
Class A Series 2 Preference Shares: (TSX) FN.PR.B

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