2021 ANNUAL REPORT

FIRST NATIONAL
FINANCIAL CORPORATION

CORPORATE PROFILE

Founded in 1988, First National is a leading non-bank mortgage lender active across Canada. Our mortgage loan solutions are used by hundreds of thousands of borrowers to purchase single-family, multi-unit and commercial properties. Customers choose us and independent mortgage brokers recommend us because of our service, technology advantages and broad range of competitive products, including prime (insured) and conventional mortgages.

Our common shares trade on the Toronto Stock Exchange under the symbol FN, and our preferred shares trade under the symbols FN.PR.A and FN.PR.B.

Shareholders can find more information about our people, business lines and markets at www.firstnational.ca.

Sustainability Report

Sustainability, It’s In Our Nature is the title of our initial Public Accountability Statement. This document, available on our website, explores our approach to sustainability and provides environmental, social and governance disclosure that was reviewed and approved by our Board of Directors.

FIRST NATIONAL BY THE NUMBERS

298,990

Single family residential customers served by First National in 2021 across Canada.

$150+B

The dollar value of housing loans First National has made since its IPO in 2006, including to first-time buyers to help them realize their dreams of home ownership.

$123.9B

Mortgages Under Administration (MUA) – the source of most of the Company's earnings – reached this milestone at year-end 2021, a 4% increase over 2020.

$1.39B

Revenue in 2021 increased 1% over 2020.

5,692

Commercial customers served by First National in 2021 across Canada.

#1

First National is independently certified as a Great Place to Work® and proud to be recognized by the Great Place to Work institute as one of Canada's top employers since 2017.

1,579

The number of people we employ at First National grew by 30% year-over-year in 2021 as we responded to record mortgage demand with record job creation.

$194.6M

Record net income in 2021 ($3.20 per share) was achieved.

39%

After-tax Pre-Fair Market Value[1] return on shareholders' equity in 2021 demonstrated the efficiency of the First National business model.

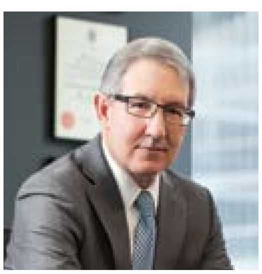
[1] Non-IFRS measure. See MD&A for more details.

OUR LEADERSHIP TEAM

STEPHEN SMITH
Co-founder, Executive
Chairman of the Board

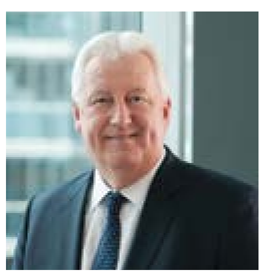
MORAY TAWSE
Co-founder and
Executive Vice President

JASON ELLIS
President and
Chief Executive Officer



ROBERT INGLIS
Chief Financial Officer

HILDA WONG
Senior Vice President and
General Counsel



SCOTT MCKENZIE
Senior Vice President,
Residential Mortgages

JEREMY WEDGBURY
Senior Vice President,
Commercial Mortgages

THOMAS KIM
Senior Vice President
and Managing Director,
Capital Markets

A MESSAGE TO OUR STAKEHOLDERS

I write this letter to you at an exciting time in our corporate history. In January 2022, with the approval of our Board of Directors, I passed the First National leadership torch to Jason Ellis as part of our planned succession. After serving for 34 years as founding CEO, I move to the role of Executive Chairman of the Board.

By no means is this a goodbye letter. Like my partner and First National co-founder Moray Tawse, we remain actively involved in the life of our company as major shareholders and Board members, but now from an organizational perspective, in governance and advisory capacities.

On the occasion of Jason's appointment, I will use the opening of this year's message to tell you more about him. Part two describes what I have learned about our business during my time in the CEO's chair. Part three comments on what I refer to as a reset in our markets and its impact on performance. The last section offers my thoughts on our outlook and business priorities.

Introducing our New CEO

With Jason's appointment as Chief Executive Officer, First National put in place a proven leader who will take us into a new era of growth, performance and development.

Jason joined us in 2004 as Senior Vice President and Managing Director, Capital Markets. For 14 years, he managed residential and commercial mortgage pricing, mortgage securitization activity, relationships with our institutional investing partners, liquidity management and fixed income and derivative trading. These activities grew more complex as First National itself grew from the time Jason started (about $12 billion in Mortgages Under Administration) to the time he was promoted to the role of Chief Operating Officer in October 2018. Jason's appointment as our COO was widely and correctly perceived to be the start of my succession plan. As a further succession signal, Jason added the title President to his COO duties in 2019.

During my planned transition, Jason's leadership skills were on display many times as our senior management team worked closely together to grow important aspects of our business including third-party underwriting and fulfillment services, our residential Excalibur mortgage product, and a new conventional commercial mortgage program.

A significant test of those leadership qualities was provided by the pandemic. In March 2020, Jason led the mobilization of the entire First National team such that we were able to quickly, safely and effectively sustain operational excellence across the organization at a time when Canadians counted on us more than ever to lend and support them through difficult times. I can say with confidence that all of us, Jason included, have learned a fair amount about business continuity and remote work since COVID-19 began.

I am impressed with what has been accomplished by our team and look forward to seeing what Jason and our leadership group do for an encore in 2022.

“When we succeed in delivering value to customers, partners and employees, we create the opportunity to reward our shareholders.”

It’s In Our Nature: Reflections on First National’s Journey

We have always believed that to deliver value for our shareholders, First National must first create value for employees, partners and customers. This is not a revolutionary thought but has required constant attention and a balanced management focus.

Starting with our workforce, our approach is to sustain a culture of mutual respect where our team is challenged in a positive way, given the tools and encouragement to succeed, and recognized for accomplishing mutually agreed upon goals. We often hear the term *family* used to describe our business culture, which reflects the fact that we strive to care enough to help each other succeed. Our reputation as an employer that empowers rather than stifles creativity has certainly helped us to recruit and retain great talent over many years, including in 2021 when we grew our workforce by 30% or 368 full-time equivalent positions.

As First National grows, we cannot take for granted that our special brand as an employer will be preserved. The pandemic’s work-from-home contingency is a further threat to our culture as physical proximity is important for personal connections and leads to the free-flow exchange of values and perspectives. Our solution to this problem has been to step up the pace of socially engaging staff activities, enhance the formal channels we use to communicate with and listen to our team, and innovate in the use of technology as it applies to skills development and coaching. In 2022, we will also introduce a Digital by Design movement whereby our workforce, on an organized basis, will use a hybrid work-in office, work-from-home model. Whether this is the future of work has yet to be determined, but it certainly offers advantages in this COVID environment for individual team members and for the preservation of our culture.

While it is true that our business cannot excel without great employees, it is equally evident that First National cannot succeed without its mortgage broker partners who themselves are increasingly important service providers to Canadians. We pride ourselves on working with independent mortgage brokers who come to First National for one reason: to get the very best mortgage offer for their clients. We understand our role in this equation and that brokers have many competitive choices. Our job is to make First National stand out not just through the design and scope of our products but in the timely, thoughtful, and respectful way that we respond to broker-created opportunities. In the past two years, we have substantially grown our workforce, as noted above, specifically to ensure we have the resources to serve our partners and our customers.

During our journey from start up to one of Canada’s largest non-bank mortgage lenders, we have been innovators in the use of information technology as it applies to service delivery. In many ways, our technology initiatives created First National’s very first competitive advantage. Through our MERLIN® underwriting system, we were early enablers of anywhere/anytime broker access to information. By creating a paperless, 24/7 commitment management platform for mortgage brokers, we have made their job and ours better and faster. A commonly understood truth is that no financial institution of the size, scale and complexity of First National can afford to let its technology atrophy. For that reason, we do our best to innovate every year.

Of course, the most fundamental truth of all is that First National exists only with and because of our customers. Today, we lend to over 300,000 Canadians and our purpose is clear: to provide them with the capital they need, when they need it, to buy homes and commercial properties. We have an obligation and a passion for customer service, which allows First National to retain mortgage business through renewal opportunities. We are proud to note that some of our commercial borrowers have financed dozens of properties with us over several decades as they have found value in the advice and market intelligence we offer. For residential borrowers, we strive to provide useful support through the lifecycle of their mortgages and, as in the case of service to brokers, use technology to create a better customer experience. We are particularly pleased to note that in 2021, we automated part of First National's customer-facing residential mortgage portal known as *My Mortgage* to reduce manual entry of customer requests for e-statements. This advancement improved efficiency and customer service. There are more such opportunities to automate, and they are embedded in our technology roadmap.

Since First National is not a deposit-taking institution, our funding model is diverse and includes securitization, placements with institutional investors, and our own balance sheet. Relationships with institutional customers, whether in funding or servicing, are therefore critically important to us and have been throughout our journey. We strive to respond to the needs of institutional clients, provide them with opportunities that fit within their risk-return requirements and meet the highest standards of servicing excellence. First National's capabilities have allowed us to add to and expand our institutional relationships over the years.

Institutional business includes third-party underwriting and fulfillment processing. We created this business line in 2014 with one customer and added another institutional client in 2019. We like this business as it allows us to leverage our skill sets and our MERLIN system to create value for customers and First National. True to form, we will look to continue to grow this business which diversifies our revenues – a sensible objective.

When we succeed in delivering value to customers, partners and employees, we create the opportunity to reward our shareholders. I am proud to say this opportunity has arisen every year since our founding. While I will discuss financial performance in part three of this message, I will note here that First National has:

- Paid $1.6 billion ($29.32 per share) in cumulative dividends and distributions since our initial public offering in 2006
- Achieved a 609% total shareholder return between our IPO in 2006 and December 31, 2021
- Generated a five-year average 41% after-tax, Pre-Fair Market Value return on shareholders' equity, which demonstrates the efficiency of our business model

As I reflect on performance over many years, I believe First National has achieved a good balance for all stakeholders. It is now part of our nature to think and act with everyone in mind.

A Reset to the Norm

The past two years, starting in March 2020, featured unforeseen events and unpredictable outcomes. Initially, the pandemic created a sharp and steep drop in employment and business confidence, but what followed was a steep and sharp ascent in various economic indicators.

Through this initial period of adjustment, and somewhat paradoxically, demand for mortgages soared as Canadians moved to purchase real estate even while there was a noticeable decline in competition for business among some lenders.

In the first waves of COVID-19, First National followed our traditional contrarian approach and continued to lend. We were rewarded with sizeable mortgage origination growth, including in the fourth quarter of 2020 when real estate markets typically slow due to seasonality. A lack of normal competitive intensity also led to abnormally wide mortgage spreads that year.

As 2021 progressed, conditions reset. While full year-over-year growth in single-family mortgage originations was extraordinary, originations slowed in the second half. Part of this deceleration reflected the incredible volumes in the comparative periods of 2020, but it also became apparent that the demand seen in 2020 and early 2021 was not sustainable. The reset also affected mortgage spreads as competition returned.

As a result of these factors, First National's 2021 performance highlights were mixed. Mortgages Under Administration ("MUA") increased 4% year over year to $123.9 billion on a 22% increase in mortgage originations, which stood at a record $23.4 billion. However, Pre-FMV Income(1) was lower at $257.3 million compared to $323.0 million in 2020 reflecting the mortgage spread environment and shifts in product mix and our funding strategy. Our MD&A contains pertinent details of the mortgage spread environment and our decision to shift commercial segment product from institutional placement to securitization – which creates revenue in future periods. When reviewing all of this information, I think the most salient takeaway is this: First National exited 2021 in a strong position, financially and competitively.

(1) Non-IFRS measure. See MD&A for details.

Business Outlook and Priorities

The reset in our markets and in the broader economy is likely to be further affected by a change in monetary policy in 2022 with the Bank of Canada raising the overnight rate. This rate was lowered in March 2020 to just 0.25% and kept at this level as a monetary policy-based stimulant throughout 2021. This move contributed to the torrid pace of home buying activity. Simultaneously, a lack of housing for re-sale sent home prices up. In the core segments of commercial real estate where First National lends, land and property values also grew.

It is impossible to tell how consumers will react to increases in borrowing rates, but we do believe that single-family mortgage originations will be lower to start 2022. This change or reset was inevitable. We also believe prepayment activity — a profitability headwind that was elevated in 2021 — will diminish.

Against this backdrop, First National will do what it has done in the past: seek to create value for its full range of stakeholders. This year, we will again invest in our workforce through training and on-the-job learning, and look to technology advancements to enhance service and, wherever possible, improve efficiency. We will work collaboratively with mortgage brokers, and we will strive to give all customers our best.

It has been my distinct pleasure to serve as Chief Executive Officer of First National and to assume the role of Executive Chairman of the Board. In my new position, I will continue to work closely with Jason as he puts his stamp on our business, and my dedicated fellow Directors as we provide guidance and lend our experience and expertise.

My thanks to everyone who makes First National a great business. We look forward to a future of service for all.

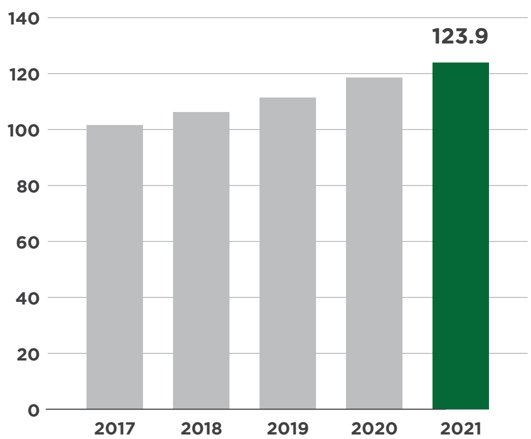
Yours sincerely,

Stephen Smith

Stephen Smith
Executive Chairman of the Board

March 1, 2022

Mortgages Under Administration ($ Billions)

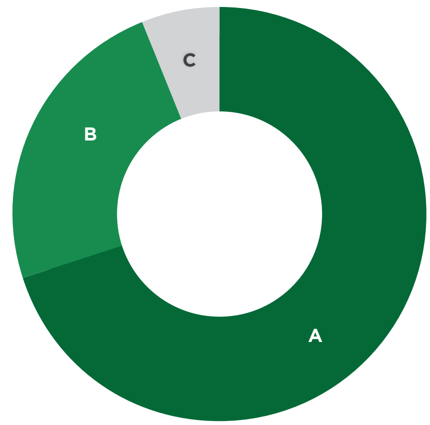


2021 MUA by Asset Type

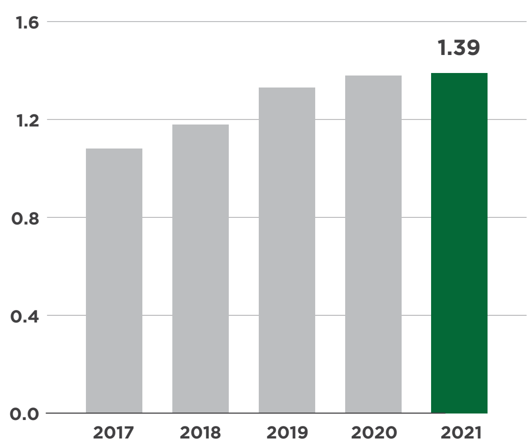
A **70%** Insured

B **24%** Uninsured single-family residential

C **6%** Uninsured multi-residential and commercial



Revenue ($ Millions)

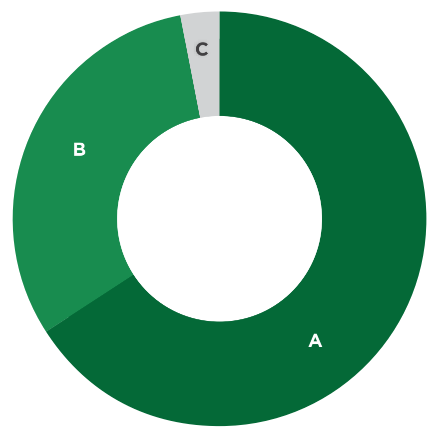


2021 Funding Sources

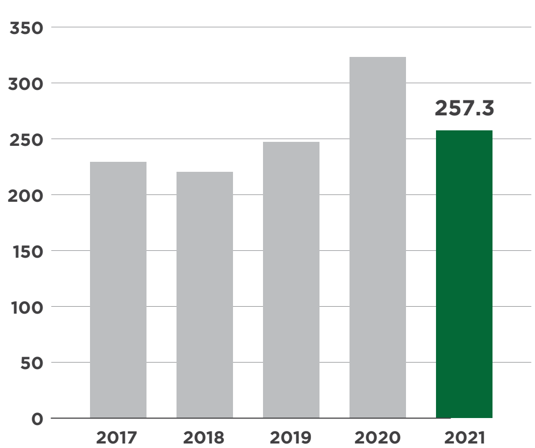
A **66%** Institutional investors

B **31%** Securitization

C **3%** Internal



Pre-Fair Market Value Income[1] ($ Millions)



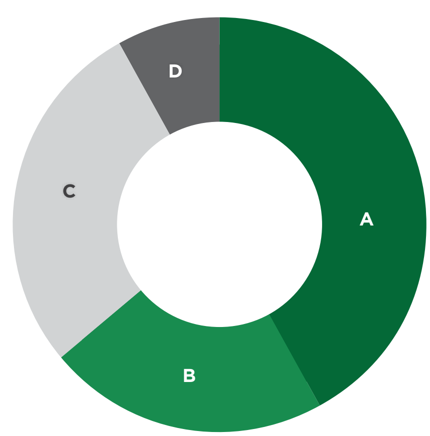
2021 Revenue Sources Prior to Fair Value Gains/Losses

A **42%** Institutional placements

B **22%** Net interest – securitized mortgages

C **28%** Mortgage servicing

D **8%** Investment income



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

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 March 1, 2022. 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, 2021. 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" on page 41 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 Income" 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 almost $124 billion in Mortgages Under Administration ("MUA"), First National is one of Canada's largest non-bank originators and underwriters of mortgages and is among the top three in market share in the mortgage broker distribution channel.

2021 Results Summary

Management is pleased with First National's performance in 2021. Supported by a robust housing market across Canada, the Company increased single-family origination 22% year over year. Commercial segment originations were up by 7% as conventional lending picked up to augment insured mortgage volumes. Total combined new origination was higher by 17% comparing both years. As a result, Mortgages Under Administration (MUA), the source of most of the Company's earnings, increased to a record high. Profitability measures were solid despite a significant decline in mortgage spreads, particularly in the final six months of 2021. In the prior year, such spreads were abnormally wide due to pandemic-related effects on interest rates and competition.

The following summarizes the performance of the Company's significant metrics:

- MUA grew to $123.9 billion at December 31, 2021 from $118.7 billion at December 31, 2020, an increase of 4%; the growth from September 30, 2021, when MUA was $122.3 billion, was 5% on an annualized basis.

- Total new single-family mortgage origination was $23.4 billion in 2021 compared to $19.2 billion in 2020, an increase of 22%. The Company attributes this to a robust real estate market and a strong market share in the mortgage broker distribution channel which is the result of the Company's long-time broker relationships built on good service, competitive products and effective technology. Commercial segment origination of $9.7 billion was 7% higher than the $9.1 billion originated in 2020. Total new origination increased by 17% in 2021 compared to 2020.
- The Company took advantage of available opportunities in the year to renew over $6.3 billion of single-family mortgages ($6.7 billion a year ago). For the commercial segment, renewals were higher by 35% ($2.7 billion compared to $2.0 billion a year ago). The Company believes the lower single-family results are the result of some borrowers choosing to refinance to take advantage of low mortgage rates which reduces its opportunities.
- Revenue for 2021 increased by 1% to $1.39 billion from $1.38 billion in 2020. This change was the result of higher gains related to changes in fair market value of financial instruments. Largely because of the financial disruption experienced at the start of the pandemic, the Company incurred losses on holding financial instruments related to interest rate hedging of $67 million. In 2021, there were gains of $5.8 million. Lower revenue was also evident in placement transactions. This was the result of mortgage spread compression between 2021 and 2020. Commercial placement fees, in particular, were lower due to a change in funding mix. With a greater proportion of insured mortgages being allocated for securitization, the Company sacrificed placement fees in 2021 for future net securitization margin.
- Income before income taxes was $263.8 million in compared to $258.7 million in 2020. The increase reflected the result of changing capital market conditions in the comparative years. Excluding gains and losses related to financial instruments, the Company's earnings before income taxes and gains and losses on financial instruments ("Pre-FMV Income")[1] for 2021 decreased by 20% to $257.3 million from $323.0 million in 2020. This change was largely the result of a return to pre-pandemic spread environment and shifts in the commercial segment's product mix and resulting funding strategy to allocate more origination volume to securitization as opposed to institutional placement. Generally, the increase in commercial origination volume was for uninsured products which is less profitable than insured origination. Together with increased borrower preference for shorter-term insured mortgages, per unit placement fee revenue for the commercial segment was lower than in 2020.

In the fourth quarter of 2021, the Company's Board of Directors announced a special common share dividend in the amount of $1.25 per share, which was paid on December 15, 2021, to shareholders of record on November 30, 2021. This payment reflected the Board's determination that the Company generated excess capital in the past year and that the capital needed for near-term growth could be generated from current operations. As a result of an increase in the Company's monthly common share dividend in June 2021 – to an annualized rate of $2.35 per share – and this special dividend, First National declared a record $210.9 million in common share dividends in 2021.

Selected Quarterly Information

Quarterly Results of First National Financial Corporation

($000s, except per share amounts)

	Revenue	Net Income (loss) for the Period	Pre-FMV Income for the Period[1]	Net Income (loss) per Common Share	Total Assets
2021					
Fourth quarter	**$339,292**	**$41,971**	**$57,045**	**$0.69**	**$42,274,158**
Third quarter	**$353,704**	**$47,614**	**$64,867**	**$0.78**	**$40,763,169**
Second quarter	**$365,118**	**$52,401**	**$71,218**	**$0.86**	**$41,727,249**
First quarter	**$336,492**	**$52,575**	**$64,146**	**$0.87**	**$40,586,601**
2020					
Fourth quarter	$387,303	$69,123	$94,937	$1.13	$39,488,527
Third quarter	$373,760	$72,517	$99,644	$1.20	$38,314,904
Second quarter	$344,581	$50,844	$75,506	$0.84	$39,040,298
First quarter	$274,650	($2,255)	$52,921	($0.05)	$39,203,792

[1] This non-IFRS measure adjusts income before income taxes by eliminating the impact of changes in fair value by adding back losses on the valuation of financial instruments (except those on mortgage investments) and deducting gains on the valuation of financial instruments. See Key Performance Indicators section in this MD&A and reconciliation below.

Reconciliation of Quarterly Determination of Pre-FMV Income[1]

($000s, except per share amounts)

	Income (loss) before income tax for the Period	Add/deduct Realized and unrealized losses (gains)	Deduct (losses), add gains related to mortgage and loan investments	Pre-FMV Income for the Period[1]
2021				
Fourth quarter	**$57,111**	**$71**	**($137)**	**$57,045**
Third quarter	**$65,134**	**$383**	**($650)**	**$64,867**
Second quarter	**$70,101**	**$1,217**	**($100)**	**$71,218**
First quarter	**$71,475**	**($7,486)**	**$157**	**$64,146**
2020				
Fourth quarter	$94,273	($260)	$924	$94,937
Third quarter	$98,767	$1,477	($600)	$99,644
Second quarter	$68,944	$7,562	($1,000)	$75,506
First quarter	($3,255)	$58,576	($2,400)	$52,921

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 mortgage rates. Recently MUA has increased, and revenue followed. Net income is partially dependent on conditions in bond 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. By removing this volatility and analyzing Pre-FMV Income, management believes a more appropriate measurement of the Company's performance can be assessed.

In the past eight quarters, the Company experienced a relatively volatile economic environment. In 2019, the economic outlook was positive and there was a surplus of liquidity for investment in financial assets. This bred a competitive marketplace but one in which mortgage funding spreads were relatively steady and the Company earned consistent revenue and net income. 2020 began slowly and volumes were not particularly strong. COVID-19-related financial turmoil at the end of 2020's first quarter created large losses on financial instruments and the Company reported a small loss. In the final three quarters of 2020, the Company benefited from both its business model, which does not rely on face-to-face interactions, and abnormally wide mortgage spreads. The spreads were the result of the aftermath of the COVID-19-related financial crisis that began at the end of the 2020 first quarter. These spreads were the basis for growth in Pre-FMV Income in the last three quarters of 2020. To start 2021, net income remained steady as financial markets stabilized and the Company earned income from higher origination volumes and wider spreads locked in its securitization portfolio. Competition accelerated in mid-2021 on signs of an improving economy and a risk-on environment and, over the past six months, spreads returned to pre-pandemic levels. The ensuing spread tightening reduced profitability for the Company in the third and fourth quarter of 2021 compared to periods of exceptional profitability in 2020.

[1] This non-IFRS measure adjusts income before income taxes by eliminating the impact of changes in fair value by adding back losses on the valuation of financial instruments (except those on mortgage investments) and deducting gains on the valuation of financial instruments. See Key Performance Indicators section in this MD&A.

Outstanding Securities of the Corporation

At December 31, 2021, and March 1, 2022, the Corporation had 59,967,429 common shares; 2,984,835 Class A preference shares, Series 1; 1,015,165 Class A preference shares, Series 2; 200,000 November 2024 senior unsecured notes; and 200,000 November 2025 senior unsecured notes outstanding.

Selected Annual Financial Information and Reconciliation to Pre-FMV Income[1]

($000s, except per share amounts)

	2021	2020	2019
For the year ended December 31, Income Statement Highlights			
Revenue	**1,394,606**	1,380,294	1,326,523
Interest expense – securitized mortgages	**(630,279)**	(708,162)	(739,071)
Brokerage fees	**(201,786)**	(159,018)	(102,596)
Salaries, interest and other operating expenses	**(298,720)**	(254,385)	(243,143)
Add (deduct): realized and unrealized losses (gains) on financial instruments	**(5,815)**	67,355	9,655
Deduct: unrealized losses regarding mortgage investments	**(730)**	(3,076)	(4,300)
Pre-FMV Income[1]	**257,276**	323,008	247,068
Add (deduct): realized and unrealized gains (losses) on financial instruments excluding those on mortgage investments	**6,545**	(64,279)	(5,355)
Provision for income taxes	**(69,260)**	(68,500)	(64,500)
Net income	**194,561**	190,229	177,213
Common share dividends declared	**210,885**	148,419	144,421
Per Share Highlights			
Net income per common share	**3.20**	3.12	2.90
Dividends per common share	**3.52**	2.47	2.41
At Year End Balance Sheet Highlights			
Total assets	**$42,274,158**	$39,488,527	$37,685,593
Total long-term financial liabilities	**$398,888**	$398,554	$374,025

Notes:

[1] Pre-FMV Income is not a recognized earnings measure under IFRS and does not have a standardized meaning prescribed by IFRS. Therefore, Pre-FMV Income may not be comparable to similar measures presented by other issuers. Investors are cautioned that Pre-FMV Income 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. The figures for 2019 have been restated to conform to the 2021 and 2020 presentation.

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 a leading non-bank mortgage lender. 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 business processes and service to mortgage brokers and borrowers; 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 ("MUA")

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, create longer-term value from servicing rights, renewals and the growth of the customer base for marketing initiatives. As at December 31, 2021, MUA totalled $123.9 billion, up from $118.7 billion at December 31, 2020, an increase of 4%. The growth of MUA in the fourth quarter of 2021, was 5% on an annualized basis.

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. Increased origination satisfies demand from its institutional customers and produces volume for the Company's own securitization programs. In 2021, the Company's single-family origination increased. The Company believes this is the result of its strong broker relationship and technology, which have both been significant benefits in the pandemic period. Generally, the Company's business practices do not rely on face-to-face interactions. Together with a lower interest rate environment, the Company's single-family origination grew by 22% in 2021 compared to 2020. The commercial segment had a strong year. Total commercial volumes increased by 7% to $9.7 billion compared to $9.1 billion in 2020. Together, overall new origination for 2021 increased 17% year over year.

Third-Party Mortgage Underwriting and Fulfilment Processing Services

In 2015, the Company launched its third-party underwriting and fulfilment processing services business with a large Canadian schedule I bank ("Bank"). This 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. In late 2019, the Company entered into a similar agreement with another Canadian bank.

Excalibur Mortgage Products

The Company originates alternative single-family ("Excalibur") mortgage products. Alternative lending describes single-family residential mortgages that are originated using broader underwriting criteria than those applied in originating prime mortgages. These mortgages generally have higher interest rates than prime mortgages. First National's relationships with mortgage brokers and its underwriting systems allow for cost effective origination of significant volumes. The product is originated primarily for placement with institutional investors, but beginning in April 2019, the Company finalized an agreement with a bank-sponsored securitization conduit to fund a portion of the Excalibur origination. In early 2020, an agreement was entered into with another bank-sponsored conduit to provide additional funding for this product. The Excalibur relaunch was rolled out gradually, beginning in Ontario. Currently the program originates the majority of its mortgages in Ontario with a small but growing amount in Western Canada.

Raising Capital for Operations

Bank Credit Facility

The Company has a $1.5 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 second quarter of 2021, the Company extended the term of the facility by two years to March 2026 and increased the commitment amount by $250 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 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.

Note Issuance

In November 2020, the Company issued 200,000 2.961% Series 3 senior unsecured notes for a five-year term pursuant to a private placement under an offering memorandum. These notes add to the Company's 2019 issuance of 200,000 3.582% Series 2 senior unsecured notes. The net proceeds of both offerings, after broker commissions, were invested in FNFLP. On settlement, the proceeds were used to pay down a portion of the indebtedness under the bank credit facility. The Company's medium-term debt capital now stands at approximately $400 million.

Preferred Share Issuance

Pursuant to the original prospectus, effective April 1, 2021, the Company reset the annual dividend rate on the outstanding Class A Series 1 preference shares to 2.895% for a five-year term to March 31, 2026. After the exercise of shareholder conversion rights in March 2021, there were 2,984,835 Class A Series 1 shares outstanding and 1,015,165 Class A Series 2 outstanding. The Series 2 shares bear a floating rate dividend calculated quarterly based on the 90-day T-Bill rate. Both the Series 1 and Series 2 shares pay quarterly dividends, subject to Board of Directors' approval, and are redeemable at the discretion of the Company such that after each five-year term ending on March 31, 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 (and 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.

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 served as an issuer and administrator of NHA-MBS 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 Canada Mortgage Bonds ("CMB") program. Issuer status provides 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 to the right.

Generally, when this spread is wider, the Company can earn higher returns from its securitization activities, although funding spreads also affect profitability. Between 2009 and 2019, liquidity issues at financial institutions created by the 2008 financial crisis diminished and the competition for mortgages increased such that spreads tightened in the 10-year period as shown above, falling to a low of 1.10% in the third quarter of 2018. Toward the end of the first quarter of 2020, fears of a global pandemic related to COVID-19 led to a dramatic and sudden decrease in bond yields as central banks cut overnight rates significantly. Credit spreads widened and the capital markets ceased to function normally. In the second quarter of 2020, as financial systems began to normalize, mortgage coupons remained elevated as other credit spreads, including those on NHA-MBS, narrowed. The resulting spreads had positive impacts on 2020 results and increased the profitability inherent in the Company's securitization portfolio. In 2021, spreads narrowed returning to 2018 levels at first and then closing to levels not seen since before the 2008 financial crisis. In 2021, the Company originated and renewed for securitization purposes approximately $8.9 billion of single-family mortgages and $4.0 billion of multi-unit residential mortgages.

The Company is subject to various regulations put in place by CMHC to control the amount of NHA-MBS that a single issuer can create. These rules include the amount of CMHC guarantees that is a requirement to issue a pool. Currently there is a tiered NHA-MBS guarantee fee pricing structure, such that any guarantees issued to one issuer over $9.0 billion of issuance have a higher price. The tiered limit of $9.0 billion remains unchanged for 2022.

Period	Average Five-Year Mortgage Spread for the Period
2006	1.12%
2007	1.50%
2008	2.68%
2009–2016	1.77%
2017–2018	1.36%
2019	1.42%
2020	1.76%
2021	1.17%

Canada Mortgage Bonds (CMB) Program

The CMB program is an initiative where Canada Housing Trust ("CHT") issues securities to investors in the form of semi-annual interest-yielding five- and 10-year bonds. 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.

Key Performance Indicators

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

- Earnings before income taxes and losses and gains on financial instruments, with the exception of any losses related to mortgage investments ("Pre-FMV Income"[1]); and
- Dividend payout ratio.

Beginning in 2012, the Company used Pre-FMV EBITDA as a key performance measure. This non-IFRS measure was used to adjust the Company's earnings by excluding gains and losses related to the fair value of financial instruments and adding back depreciation and amortization. The addbacks of amortization ended in 2016 when IPO-related intangible assets were fully amortized. Accordingly, effective January 1, 2020, the Company elected to simplify the non-IFRS measure it presents to adjust only for fair value-related gains and losses. This measure is reported as "Pre-FMV Income." Measures prior to 2020 were restated in accordance with this revised calculation. Pre-FMV Income is not recognized under IFRS. However, management believes that Pre-FMV Income is a useful measure that provides investors with an indication of income normalized for capital-market fluctuations. Pre-FMV Income 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 Income may differ from other issuers and, accordingly, Pre-FMV Income may not be comparable to measures used by other issuers.

	Quarter Ended		**Year Ended**	
($000s)	December 31, 2021	December 31, 2020	December 31, 2021	December 31, 2020
For the Period				
Revenue	**339,292**	387,303	**1,394,606**	1,380,294
Income before income taxes	**57,111**	94,273	**263,821**	258,729
Pre-FMV Income[1]	**57,045**	94,937	**257,276**	323,008
At Period End				
Total assets	**42,274,158**	39,488,527	**42,274,158**	39,488,527
Mortgages Under Administration	**123,907,627**	118,723,990	**123,907,627**	118,723,990

Note:
[1] This non-IFRS measure adjusts income before income taxes by eliminating the impact of changes in fair value by adding back losses on the valuation of financial instruments (except those on mortgage investments) and deducting gains on the valuation of financial instruments (except those on mortgage investments).

Since going public in 2006, First National has been considered a high-yielding, dividend-paying company. With a large MUA that generates continuing income and cash flow and a business model that is designed to make efficient use of capital, the Company has been able to pay distributions to its shareholders that 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 paid out as dividends. Similar to the performance measurement for earnings, the Company also calculates the dividend payout ratio on a basis using after-tax Pre-FMV Income.

Determination of Common Share Dividend Payout Ratio

($000s)	Quarter Ended December 31, 2021	Quarter Ended December 31, 2020	Year Ended December 31, 2021	Year Ended December 31, 2020
For the Period				
Net income attributable to common shareholders	**41,287**	68,465	**191,866**	187,383
Total dividends paid or declared on common shares	**110,190**	60,717	**210,885**	148,419
Dividends paid or declared on common shares, excluding special dividends	**35,231**	30,733	**135,926**	118,435
Total common share dividend payout ratio	**267%**	89%	**110%**	79%
Regular common share dividend payout ratio[1]	**85%**	45%	**71%**	63%
After-tax Pre-FMV dividend payout ratio[2]	**85%**	45%	**73%**	50%

Note:
[1] This ratio is calculated by excluding the payment of the special dividends declared at the end of the years presented.
[2] This non-IFRS measure adjusts the net income used in the calculation of the "Regular common share dividend payout ratio" to after-tax Pre-FMV Income so as to eliminate the impact of changes in fair value by adding back losses on the valuation of financial instruments (except those on mortgage investments) 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 the year ended December 31, 2021, the common share payout ratio was 110% compared to 79% for the year ended December 31, 2020. However, in both 2021 and 2020, the Company declared a special dividend and recorded gains and losses on account of the changes in fair value of financial instruments. Gains and losses are recorded in the period in which the prices on Government of Canada bonds change; however, the offsetting economic impact is generally reflected in narrower or wider spreads in the future once the mortgages have been pledged for securitization. Accordingly, management does not consider such gains and losses to affect its dividend payment policy in the short term. If the special dividends and gains and losses on financial instruments in the two years are excluded from the above calculations, the dividend payout ratio for 2021 would have been 73% compared to 50% in 2020.

The Company also paid $2.7 million of dividends on its preferred shares in 2021 ($2.8 million in 2020).

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. In general, originations are allocated from one funding source to another depending on different criteria, including type of mortgage and securitization limits, with an overall consideration related to maintaining diversified funding sources. The Company retains servicing rights on virtually all the mortgages it originates, which provide the Company with servicing fees to complement revenue earned through originations. For the year ended December 31, 2021, new origination volume increased to $33.2 billion from $28.3 billion, or about 17%, compared to 2020.

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 $42.1 billion of new originations and renewals in 2021, $12.9 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 placed. 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 $42.1 billion of new originations and renewals in 2021, $27.8 billion was placed with institutional investors.

For all institutional placements, 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 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 two mortgage originators 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 are included in "Mortgage servicing income" in the consolidated statement of income.

Results of Operations

The following table shows the volume of mortgages originated by First National and Mortgages Under Administration for the periods indicated:

($ millions)	Quarter Ended December 31, 2021	Quarter Ended December 31, 2020	Year Ended December 31, 2021	Year Ended December 31, 2020
Mortgage Originations By Segment				
New single-family residential	**5,218**	5,962	**23,414**	19,165
New multi-unit and commercial	**3,045**	2,723	**9,747**	9,112
Sub-total	**8,263**	8,685	**33,161**	28,277
Single-family residential renewals	**1,491**	1,648	**6,306**	6,668
Multi-unit and commercial renewals	**902**	558	**2,658**	1,962
Total origination and renewals	**$10,656**	$10,891	**$42,125**	$36,907
Mortgage Originations by Funding Source				
Institutional investors	**6,863**	8,011	**27,813**	25,019
NHA-MBS/CMB/ABCP securitization	**3,475**	2,547	**12,923**	11,036
Internal Company resources/CMBS	**318**	333	**1,389**	852
Total	**$10,656**	$10,891	**$42,125**	$36,907
Mortgages Under Administration				
Single-family residential	**84,896**	83,601	**84,896**	83,601
Multi-unit residential and commercial	**39,012**	35,123	**39,012**	35,123
Total	**$123,908**	$118,724	**$123,908**	$118,724

Total new mortgage origination volumes increased in 2021 compared to 2020 by 17%. Single-family volumes increased by 22% and commercial segment volumes increased by 7% year over year. Management believes the growth in the single-family segment was due to several factors that include its strong broker and investor relationships, robust market conditions, and its MERLIN technology and operating systems, which support physical distancing and allowed the Company to continue to underwrite efficiently during the pandemic. Lower mortgage rates also encouraged home purchasing across the country. In the commercial segment, the Company's expertise in underwriting multi-unit mortgages is a fundamental competency. After a slow start to 2021, commercial origination volumes increased 7% in 2021 compared to 2020. When combined with renewals, total production for both business segments increased by 14% to $42.1 billion in 2021 from $36.9 billion in 2020. Origination for direct securitization into NHA-MBS, CMB and ABCP programs remained a large part of the Company's strategy, with volume of $12.9 billion in 2021.

Net Interest – Securitized Mortgages

Comparing the year ended December 31, 2021, to the year ended December 31, 2020, "net interest – securitized mortgages" increased by about 26% to $163.2 million from $129.4 million. The portfolio of mortgages pledged under securitization grew 4% from about $34.1 billion at December 31, 2020, to $35.4 billion at December 31, 2021. The growth in profitability was due to several factors: the reduction in the amount of indemnities payable to MBS bondholders, growth in the commercial portfolio which grew at rate of 24% in 2021, and the performance of the Excalibur securitization program. These growth factors were offset by the prime residential program which experienced higher than expected rates of prepayment. Higher prepayment activity appears to be a function of a pandemic-related drop in interest rates as borrowers took advantage of lower mortgage rates to refinance their mortgages. This roll off resulted in a premature loss of income-producing assets and, as these mortgages prepaid, the Company's exposure to the cost of indemnities payable to MBS debtholders increased. The indemnities are calculated to make whole NHA-MBS debtholders and assume the prepayment principal is reinvested at risk free reinvestment rates. With the decrease in such interest rates in 2020, the cost of such indemnities increased significantly. While still relevant for the Company, indemnity costs slowed as interest rates stabilized. The Company has determined that indemnity costs in 2021 were lower by $15.9 million compared to those in 2020. Accordingly, Net Interest – Securitized Mortgages was higher by that amount in 2021. The Company's prime ABCP programs' securitization margins were tighter in 2020 as the cost of funds reacted negatively to the financial turmoil produced by the pandemic such that profitability was decreased. In comparison, 2021 interest costs were stable and securitization margins increased comparatively.

Placement Fees

Placement fee revenue decreased by 9% to $303.7 million from $333.7 million in the comparative year. The decrease was the result of several factors. Despite an 11% increase in origination volumes sold to institutional investors, mortgage spreads returned to pre-pandemic levels. Accordingly, mortgages sold on a funded basis attracted a lower per unit placement fee. For the residential segment, average per-unit fees were lower by about 13% year over year. For the commercial segment, mortgage spreads were also tighter than in 2020 and funding decisions had a significant impact on placement fees. Commercial placement fees were lower by $40.1 million year over year on tighter spreads and a shift of funding strategy from placement to securitization for 10-year insured mortgage origination. In 2021, the Company benefited from CMHC programs that increased CMB access for issuers who lend on affordability-linked real estate. This program is limited to 10-year insured mortgages, such that the Company elected to securitize a larger percentage of its insured commercial mortgage origination and there was less insured product available to place with institutional investors the Company. By shifting these mortgages to its own securitization, the Company has foregone placement fees for future net securitization margin. While arguably economically superior, the value of this securitization is recognized in income over 10 years as opposed to a placement where much of the value is recognized in the current period. In 2021, the Company securitized $2.7 billion and placed about $2.6 billion of its five- and 10-year insured origination. In 2020, the Company securitized $1.3 billion and placed about $4.6 billion of its five- and 10-year insured mortgage origination. The Company estimates that the economic value of the additional $1.4 billion of mortgages securitized is approximately $26 million. 2021 also featured a shift within insured origination from 10-year term product to five-year term product. In 2021, with a changing interest rate market, underwriting rules made it more difficult for borrowers to qualify for 10-year terms such that five-year term origination increased to the detriment of 10-year origination. Placement fees are directly linked to the term of mortgages, such that five-year mortgages provide approximately 50% lower revenue on a per-unit basis. This shift was magnified by the Company's securitization strategy. Lastly, in 2020, spreads were abnormally wide for about 9 months of the year after mortgage lenders reacted to the financial impact of the pandemic. As the Company placed these mortgages with institutional investors, it earned larger per-unit placement fees than typical. In 2021, spreads returned to pre-pandemic levels about mid year such that spreads were between 15 to 50% lower than just 12 months prior.

Gains on Deferred Placement Fees

Gains on deferred placement fees revenue decreased 50% to $16.1 million from $32.4 million. These gains related primarily to multi-unit residential mortgages originated and sold to institutional investors. Volumes for these transactions decreased by 30% from 2020 as the Company elected to securitize directly more of the mortgages that support this revenue. Spreads on these mortgages were also narrower in 2021 compared to 2020 as described in the Placement Fees section above.

Mortgage Servicing Income

Mortgage servicing income increased 21% to $211.6 million from $175.0 million. This increase was attributable to growing administration revenue on growing MUA and growth in the Company's third-party underwriting business unit. Much like the Company's experience in single-family origination, First National's third-party underwriting customers benefited from the Company's MERLIN technology. Management believes this technology and First National's business model have been advantageous during the pandemic and led to increased origination volumes.

Mortgage Investment Income

Mortgage investment income decreased 7% to $63.9 million from $69.0 million. The decrease was due primarily to the interest rate environment. Short-term rates fell significantly in March 2020 as the Bank of Canada cut its overnight rate by 1.5%. Accordingly, most of the decrease was related to the first quarter of each year such that 2021's revenue was lower than 2020 by about $7 million. After the 2020 first quarter, the Company decreased its offered mortgage rates. The result was lower amounts of interest earned on mortgages while they are accumulated for securitization on the balance sheet.

Realized and Unrealized Gains (Losses) on Financial Instruments

This financial statement line item consists of three primary components: (1) gains and losses related to the Company's economic hedging of single-family commitments, (2) gains and losses related to holding a portfolio of mortgage and loan investments at fair value, and (3) gains and losses on interest rate swaps used to mitigate interest rate risk on its CMB activity. With the adoption of IFRS 9 in 2018, a significant portion of the Company's interest rate management program qualifies as "hedging" for accounting purposes. The Company has elected to document hedging relationships for virtually all of the multi-residential commitments and mortgages it originates for its own securitization programs. It has also done the same for funded single-family mortgages and the swaps used in its ABCP programs. This decision has reduced the volatility of gains and losses on financial instruments otherwise recorded in the Company's regular earnings, as gains and losses on hedged items are generally deferred and amortized into income over the term of the related mortgages. The Company has not documented a hedging relationship for its interest mitigation program for its single-family mortgage commitments. The Company believes, given the optional nature of these commitments, it is difficult to establish a valid hedging relationship. For financial reporting purposes, this means that there will still be gains and losses on financial instruments, but these should be limited to those on the bonds sold short used to mitigate such risk. The following table summarizes these gains and losses by category in the periods indicated:

Summary of Realized and Unrealized Gains (Losses) on Financial Instruments

	Quarter Ended		Year Ended	
($000s)	December 31, 2021	December 31, 2020	December 31, 2021	December 31, 2020
Gains (losses) on short bonds used for the economic hedging program	**3,155**	114	**15,397**	(75,689)
Gains (losses) on mortgages held at fair value	**(137)**	924	**(730)**	(3,076)
Gains (losses) on interest rate swaps	**(3,089)**	(778)	**(8,852)**	11,410
Net gains (losses) on financial instruments	**(71)**	260	**5,815**	(67,355)

In the first quarter of 2020, there were significant financial repercussions related to the pandemic. After the significant disruption in that quarter, bond yields continued to fall but at a slower pace. The impact on the Company's short-bond position used to mitigate interest rate risk on single-family commitments was $75.7 million of losses in the full year 2020. In contrast, 2021 was a more stable period where bond yields remained relatively flat with a slow rise toward the end of the fourth quarter as economic predictions suggested an inflationary environment. For 2021, the Company recorded $15.4 million of gains related to short bonds used to manage the interest rate risk of residential mortgage commitments.

Brokerage Fees Expense

Brokerage fees expense increased 27% to $201.8 million from $159.0 million. This increase reflected higher origination volumes of single-family mortgages for institutional investors, which increased by almost $3.7 billion or 28% year over year. The growth was offset by lower commercial segment broker fees and moderated by more Excalibur broker fees which are lower due to the shorter terms of these mortgages. Unit broker fees for prime residential mortgages were about 1% higher in 2021 compared to 2020.

Salaries and Benefits Expense

Salaries and benefits expense increased 23% to $177.0 million from $143.5 million. Salaries were higher as overall headcount increased by 30% (1,579 employees at December 31, 2021, compared to 1,211 at December 31, 2020). Headcount growth is primarily in the residential underwriting departments. If the impact of commercial underwriting compensation is taken out of the figures above, salaries and benefits increased by 29% between 2020 and 2021. Management salaries were paid to the two senior executives (co-founders) who together control about 71% 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") in 2006.

Interest Expense

Interest expense decreased 8% to $48.9 million from $53.2 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 investor or funding with a securitization vehicle. The Company used senior unsecured notes together with a $1.5 billion credit facility with a syndicate of banks and 30-day repurchase facilities to fund the mortgages during this period. The overall interest expense decreased from 2020 due to lower prevailing interest rates on the Company's debt, particularly when comparing the first quarter of 2021 to the pre-pandemic first quarter of 2020 when interest rates were higher.

Other Operating Expenses

Other operating expenses increased by 26% to $72.8 million from $57.6 million. The primary change in other operating expenses was a $5.8 million increase in hedging costs associated with a larger notional hedging program to support the company's securitization programs and a steepening bond yield curve which makes hedging more expensive. Expenses for depreciation were also higher than in 2020 as the Company invested in equipment to support its growing workforce and work-from-home business continuity strategy. Discretionary costs, including promotion, travel and entertainment were lower as a result of government-mandated measures related to the pandemic.

Income before Income Taxes and Pre-FMV Income[1]

Income before income taxes increased by 2% to $263.8 million from $258.7 million in 2020. This increase was largely the result of changing capital markets. The Company's results include gains or losses on account of financial instruments used to economically hedge residential mortgage commitments. As described previously in this MD&A, the Company's results include gains or losses on account of financial instruments used to economically hedge residential mortgage commitments. Because of the financial disruption related to the pandemic, large losses were recorded in 2020. All told, the Company recorded $64.3 million of losses on financial instruments (excluding losses related to mortgage and loan investments). Comparatively, in 2021, the Company recorded $6.5 million of gains on financial instruments (excluding the losses related to mortgage and loan investments). The change in these values, excluding the losses on mortgage investments, accounted for a $70.8 million increase in comparative income before income taxes. Pre-FMV Income, which excludes these changes, decreased by 20% to $257.3 from $323.0 million. Early in 2020, bond yields dropped significantly and rapidly. This had a direct and immediate effect on the financial instruments the Company uses to hedge its residential mortgage commitments. However, as those mortgage commitments transformed into funded mortgages, the Company originated mortgages with comparatively high mortgage coupons. These mortgages together with mortgages subsequently originated in the wider spread environment, produced larger placement fees as the Company placed these mortgages with investors. Management believes that the Company comparatively earned about $30 million of additional revenue from such placements. The decrease in Pre-FMV Income was also the result of the commercial segment. In 2021, earnings were affected by tighter mortgage spreads and a shift in funding sources. Because of favourable CMB treatment, the Company securitized about $1.4 billion more of its five- and 10-year insured commercial segment mortgage origination volume compared to 2020. Although perhaps economically superior, this election delays the recognition of earnings for the Company. As described previously, placement fees in the commercial segment were lower by approximately $26.0 million from the shift to securitization. This decrease directly impacted earnings as the compensation to the Company's underwriters generally does not change when mortgages are securitized as opposed to placed. Higher headcount was another unfavourable factor on earnings. In order to support the record volumes of residential mortgage origination, historically high third-party underwriting volumes and demands on information technology, headcount increased by 30% comparing 2021 to 2020. Growth in the Company's securitization portfolio and higher origination in third-party underwriting had favourable impacts on Pre-FMV Income in 2021.

[1] This non-IFRS measure adjusts income before income taxes by eliminating the impact of changes in fair value by adding back losses on the valuation of financial instruments (except those on mortgage investments) and deducting gains on the valuation of financial instruments. See Key Performance Indicators section in this MD&A.

Income Tax Expense

The provision for taxes increased by 1% to $69.3 million from $68.5 million. The provision increased proportionately with net income before income taxes.

Other Comprehensive Income ("OCI")

For the commercial segment, the Company hedges the interest rate risk associated with insured multi-residential mortgages. This hedging begins on commitment and ends when the Company either securitizes the mortgages or places the mortgage with an institutional investor. As the Company determined that these cash flow hedges were effective, the Company recorded $31.2 million of pre-tax net gains on such hedges in OCI in 2021. These gains would have been recorded as gains on financial instruments under the previous IFRS standard. In the year, the Company amortized a portion of the gains and losses in accumulated OCI into regular earnings. In 2021, this amortization totalled $3.7 million. The remaining OCI amount will be amortized into net income in future periods.

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, 2021	December 31, 2020	December 31, 2021	December 31, 2020
Originations and renewals	**29,719,176**	25,833,197	**12,404,946**	11,075,085
Percentage change	***15%***		***12%***	
Revenue	**1,030,550**	975,979	**364,056**	404,315
Percentage change	***6%***		***(10%)***	
Income before income taxes	**199,366**	141,085	**64,455**	117,644
Percentage change	***41%***		***(45%)***	
As at	December 31, 2021	December 31, 2020	December 31, 2021	December 31, 2020
Identifiable assets	**28,813,695**	28,945,884	**13,430,687**	10,512,867
Mortgages Under Administration	**84,895,778**	83,600,868	**39,011,848**	35,123,122

Residential Segment

Overall residential origination volumes including renewals increased by 15% between 2021 and 2020 while residential revenues increased by 6%. Revenue was affected by the impact of financial instruments. Excluding the impact of these revenues, adjusted revenue decreased by 2%. Revenue was negatively affected in 2021 by tighter mortgage spreads and lower mortgage rates. Narrower spreads affected placement fees which were up 4% or $10 million despite 15% growth in origination. The Company's portfolio of securitized mortgages decreased by $0.8 billion from 2020 to 2021. This change represented new mortgages added in the year of almost $9 billion offset by run-off and prepayment of almost $10 billion. The effect was the replacement of older mortgages with higher coupons with new mortgages at lower coupons reflective of the current intertest rate environment. Accordingly, revenue in this area was lower by $54 million. Lower interest rates also affected mortgage investment income and, partially, mortgage servicing revenue. Net income before tax was also affected by fair value-related revenues. Without the impact of these revenues, net income before tax decreased to $192.8 million in 2021 from $205.4 million in 2020, or by 6%. This is the outcome of the lower per-unit revenues on placement activity combined with higher headcount which has created comparatively higher operating expenses. Identifiable assets decreased from December 31, 2020, as the Company's residential portfolio of mortgages pledged under securitization decreased by about $0.8 billion. Increases in mortgages accumulated for sale and related hedge assets offset most of this decrease.

Commercial Segment

2021 commercial revenues were lower compared to 2020 largely because of a shift in the product mix in mortgage origination and a tighter mortgage spread environment. Despite the growth in origination of 12%, all of this growth has been used in securitization which produces revenue over a longer period as opposed to placement transactions. The Company elected to securitize a larger percentage of its commercial mortgage origination, specifically 10-year term insured mortgages. This has shifted the most profitable product from one that earns the Company current period placement fees to one that creates future net securitization margin. Income before income taxes decreased by 45% year over year. The decrease is due to lower placement fee revenues as described and higher comparative compensation paid to the Company's in-house underwriters. Despite mortgages being placed or securitized, these employees are paid on funding of the mortgage such that overall employee costs increased 12% in this department. Identifiable assets increased from those at December 31, 2020, as the Company increased securitized mortgages by about $2.1 billion, mortgages accumulated for securitization by $0.2 billion, and hedging related assets by $0.6 billion.

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, and once again in the COVID-19 crisis, when capital markets were disrupted and the demand for high-quality assets increased. As the Company's results in those years demonstrated, First National was able to attract 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 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 financial institutions for total credit of $1.5 billion. This facility was extended in June 2021 for a five-year term maturing in March 2026. At December 31, 2021, the Company had entered into repurchase transactions with financial institutions to borrow $1.8 billion related to $1.8 billion of mortgages held in "mortgages accumulated for sale or securitization" on the balance sheet.

At December 31, 2021, outstanding bank indebtedness was $965.4 million (December 31, 2020 – $682.8 million). Together with the unsecured notes of $399 million (December 31, 2020 – $399 million), this "combined debt" was used to fund $951.3 million (December 31, 2020 – $805.7 million) of mortgages accumulated for sale or securitization. At December 31, 2021, the Company's other interest-yielding assets included: (1) deferred placement fees receivable of $64.4 million (December 31, 2020 – $62.5 million) and (2) mortgage and loan investments of $192.3 million (December 31, 2020 – $213.3 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, increased between December 31, 2020, and December 31, 2021, and now stands at $413.0 million (December 31, 2020 – $275.8 million). This represents a debt-to-equity ratio of approximately 0.72:1. This ratio is higher than the ratio of 0.48:1 at December 31, 2020. In general, the increase was the result of investing $157 million in investments in mortgages pledged for securitization, largely to support its Alt-A securitization program. The Company believes the ratio is appropriate given the nature of the assets which the debt is funding.

Since being approved as an issuer of NHA-MBS, the Company has funded the difference between the mortgages it uses to create NHA-MBS and the debt obligations it assumes upon issuance. In recent years, this requirement has generally been limited to mortgages in arrears where First National does not receive payments from the borrower but is obliged to pay the interest and amortizing principal on the NHA-MBS debt. However, due to 2020-related national unemployment pursuant to the COVID-19 pandemic, this funding requirement increased as borrowers requested mortgage payment deferrals. In such situations, the Company determined to grant mortgage payment deferrals. Qualifying borrowers received three months of payment deferral. In cases of extended hardship, the Company provided a second three-month deferral after the initial deferral period ended. During this deferral period, a portion of such mortgages ceased to amortize and interest otherwise payable was capitalized to the principal of the mortgage. The three mortgage default insurers approved these

steps, permitting the deferrals to occur without any impact on subsequent claims under the mortgage insurance policies. In turn, First National has been required to make "timely payments" on the NHA-MBS securities. This means that despite not receiving payments from borrowers on the mortgages that support the NHA-MBS, the Company has been required to pay the interest and amortizing principal on the debt. In effect, the Company de-leveraged its balance sheet by paying off the debt while the related mortgages did not amortize as quickly. At December 31, 2021, the Company estimates that it had reduced its NHA-MBS debt by approximately $46 million (December 31, 2020 - $64 million) because of the impact of deferred payments. This has been funded by the Company's available cash resources.

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 by the Company. 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 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 before long-term financing. 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.

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, 2021, the investment in cash collateral was $105.1 million (December 31, 2020 – $88.2 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 June 30, 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.

Financial Instruments and Risk Management

Commencing January 1, 2018, the Company has recorded mortgages accumulated for sale and 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 income. The mortgages accumulated for sale are held for very short periods, and any change in value due to changing interest rates is the obligation of the ultimate institutional investor. Accordingly, the Company believes there will be little, if any, effect on its income related to the change in fair value of these mortgages. The majority of mortgages in mortgage and loan investments are uninsured commercial segment bridge loans. These are primarily floating rate loans that have mortgage terms of 18 months or less. As the mortgages do not conform to conventional mortgage lending, there are few active quoted markets available to determine the fair value of these assets. The Company estimates fair value based upon: benchmark interest rates, credit spreads for similar products, creditworthiness and status of the borrower, valuation of the underlying real property, payment history, and other conditions specific to the rationale for the loan. Any favourable or unfavourable amounts will be recorded in the statement of 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. Prior to 2018, the Company did not attempt to adopt hedge accounting; however, with the introduction of IFRS 9 on January 1, 2018, the Company began designating hedging relationships such that the results of any effective hedging will not affect the Company's statement of income. See previous discussion in this MD&A under "Realized and Unrealized Gains (Losses) on Financial Instruments". As at December 31, 2021, the Company had $1.4 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 to be sold to the Company's other securitization vehicles. As at December 31, 2021, the Company had entered into $1.1 billion of notional value forward bond sales for this segment. The Company is also a 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, 2021, the aggregate notional value of these swaps, maturing between December 2023 and September 2026, was $195 million. During 2021, the value of these swaps decreased by $8.9 million.

As described above, the Company employs various strategies to reduce interest rate risk. In the normal course of business, the Company also takes on 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 ultimate date of placement or securitization. If credit spreads widen during this holding period, this is unfavourable for the Company. It means that the Company cannot fund the mortgages originated with a funding source as effectively as originally intended. Despite entering into effective interest rate hedges, the Company's exposure to credit spreads will remain. This risk is inherent in the Company's business model and the Company believes it cannot be economically hedged. As at December 31, 2021, the Company had various exposures to changing credit spreads. In particular, in mortgages accumulated for sale or securitization, there were approximately $2.7 billion of mortgages that were susceptible to some degree of changing credit spreads.

Capital Expenditures

A significant portion of First National's business model is the origination and placement or securitization of financial assets. Generally, placement activities do not require any capital investment. Securitization transactions may require the investment of 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. The business requires capital expenditures on technology (both software and hardware), leasehold improvements, and office furniture. During the year ended December 31, 2021, the Company purchased new computer equipment and software and made leasehold improvements. In the long term, the Company expects capital expenditures on fixed assets will be approximately $10 million annually. 2021 expenditures were much higher at $32 million as the Toronto office moved to its new premises and invested in new leasehold improvements.

Summary of Contractual Obligations

The Company's long-term obligations include leases of premises with terms up to 15 years for its 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	134,426	10,339	18,966	17,639	87,482

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, 2021. The policies that 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 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 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 year ended December 31, 2021, are consistent with those used for the year ended December 31, 2020, and the quarters ended September 30, June 30 and March 31, 2021.

Effective January 1, 2018, the Company elected to treat certain of its financial assets and liabilities, including mortgages accumulated for sale, 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. A portion of the bonds sold short are designated as an effective hedge, and accordingly, a portion of the change in the short bonds' fair value may be recorded in Other Comprehensive Income or deferred against hedge assets. This accounting has reduced the volatility in earnings as changes in the value on short bonds have been matched to the recognition of the change in value of the hedged mortgages. 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 the assets listed above are subject to Company estimates. The most significant would be implicit in the valuation of mortgage and loan investments. These are generally non-homogeneous mortgages where it is difficult to find independent valuation comparatives. The Company uses information in its underwriting files, regional real estate information and other internal measures to determine the fair value of these assets.

As a mortgage lender, the Company invests in uninsured mortgages. When it funds these mortgages through securitization debt, it continues to be liable for any credit losses. The key inputs in the measurement of any expected credit loss ("ECL") include probability of default, loss given default and forecast of future economic conditions, which involves significant judgment. Upon application of IFRS 9 with respect to impairment, there has been no impact on the Company's earnings. Because of 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, no significant amount of credit losses were recorded in 2021.

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, 2021, 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, 2021.

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, 2021, and that no material weaknesses have been identified in the Company's internal control over financial reporting as of December 31, 2021. No changes were made in the Company's internal controls over financial reporting during the year ended December 31, 2021, that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

ESG

The Company issued its initial Public Accountability Statement in the fall of 2021. This report explores First National's approach to sustainability and provides environmental, social and governance (ESG) disclosure that has been reviewed and approved by our Board of Directors. It complements our Management Information Circular, Annual Information Form, Management Discussion and Analysis, and Annual Report, all of which offer more information about the financial position, priorities, responsibilities and commitments of the consolidated operations of First National.

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 including third-party servicing customers, reliance on independent mortgage brokers, changes in interest rates, repurchase obligations and breach of representations and warranties on mortgage sales, risk of servicer termination including the impact of 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 and 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, unfavourable litigation, 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 that 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. In October 2019, the sale transaction involving an institution for which the Company administers a large portfolio of third-party originated mortgages was completed. The new owners of the institution may decide not to renew the existing contract with First National or to exercise termination clauses within the agreement. In the event of non-renewal or termination, the Company's MUA will decrease. For a more complete discussion of the risks affecting the Company, reference should be made to the Company's Annual Information Form.

It became clear to the Company in mid-March 2020 that COVID-19 was highly contagious, and the Company executed its business continuity plan. In this case, the plan called for a "working from home" contingency. Within the first month, most of the Company's staff across the country transitioned to working from home. The Company is prepared for a hybrid return to office in 2022 subject to health guidelines but as of the date of this MD&A, the contingency plan remains in effect. The COVID-19 crisis has been the cause of unemployment across the country and widespread economic hardship. During the duration of this crisis, the probability of the risks listed above having a negative impact on the Company has increased. Related losses could be material.

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, that 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 March 1, 2022, 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

2021 saw a return to a fully competitive marketplace and mortgage spreads tightened to pre-pandemic levels. In some periods, spreads tightened to levels not seen since before the 2008 financial crisis. The Company successfully grew MUA despite the competitive environment and built a larger portfolio of mortgages pledged under securitization. First National will benefit from this growth in the future: earning income from mortgage administration, net securitization margin and increased renewal opportunities. In the short term, the expectation for the start of 2022 is lower origination. There are indications of slowing origination as housing inventories fall and as mortgage rates rise driven by an expected change in the Bank of Canada's monetary policy in 2022. Generally, higher interest rates will decrease affordability and dampen activity. Management estimates that residential origination will be lower than the almost $4.4 billion recorded in the comparative 2021 first quarter. Management recognizes that home purchasing in the past two years has been at levels that are likely unsustainable and that while drivers such as higher immigration are strong, a market slowdown seems inevitable. However, it is confident that First National will remain competitive and a leader in the marketplace. Management anticipates commercial origination will remain strong in 2022 based on the current pipeline.

During the pandemic, the value of First National's business model has been demonstrated. By designing systems that do not rely on face-to-face interactions, the Company's business practices have resonated with mortgage brokers and borrowers alike during this period. The economic effects of COVID-19 are expected to slowly diminish although the duration and impact of the pandemic is unknown at this time, as is the long-term efficacy of the government and central bank interventions. It is still not possible to reliably estimate the length and severity of these developments and the impact on the financial results and condition of the Company and its operating subsidiaries in future periods.

First National is well prepared to execute its business plan. In 2022, the Company expects to enjoy the value of its goodwill with broker partners earned over the last 30+ years and reinforced during the pandemic. The funding side shows strong demand for the Company's mortgages from institutional investors due to the substantial amount of liquidity in the financial system. Securitization markets are robust and provide consistent and reliable sources of funding.

The Company is confident that its strong relationships with mortgage brokers and diverse funding sources will continue to set First National apart from its competition. The Company will continue to generate income and cash flow from its $33 billion portfolio of mortgages pledged under securitization and $88 billion servicing portfolio and focus on the value inherent in its significant single-family renewal book.

Effective January 12, 2022, subsequent to year end, the Company announced the appointments of Stephen Smith as Executive Chairman of the Board and Jason Ellis as President, Chief Executive Officer and Director. Mr. Smith co-founded First National in 1988 with Moray Tawse. Since taking First National public in 2006, Mr. Smith served as the Company's founding Chairman and Chief Executive Officer and now will continue to provide strategic guidance to the management team in the newly created role of Executive Chairman. Mr. Ellis joined First National in 2004 with responsibility for First National's treasury and capital markets activities, was appointed Chief Operating Officer in 2018 and added the title of President in 2019. Mr. Ellis will be responsible for day-to-day operations and the design and maintenance of strategy in the pursuit of business excellence. Although just recently appointed as CEO, Mr. Ellis has played increasingly important strategic roles within the business for over 15 years and is dedicated to leading the organization through the next stage of growth.

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 fulfils 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.

Jason Ellis
President and Chief Executive Officer

Robert Inglis
Chief Financial Officer

March 1, 2022

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of
First National Financial Corporation

Report on the audit of the consolidated financial statements

Opinion

We have audited the consolidated financial statements of First National Financial Corporation and its subsidiaries [collectively, the "Company"], which comprise the consolidated statements of financial position as at December 31, 2021 and December 31, 2020, and the consolidated statements of income, comprehensive income, changes in equity and cash flows for the years then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as at December 31, 2021 and December 31, 2020, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards ["IFRSs"].

Basis for opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada, and we have fulfilled our ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the financial statements of the current period. These matters were addressed in the context of the audit of the financial statements as a whole, and in forming the auditor's opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the *Auditor's responsibilities for the audit of the financial statements* section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying financial statements.

Measurement of estimated credit losses

As more fully described in Note 2 and Note 3 to the financial statements, the Company is exposed to credit risk on its mortgage assets. In 2021 the Company has recorded an allowance for credit losses of $766 thousand. The Company manages credit risk by employing underwriting policies and procedures designed to minimize exposure to credit losses, and by acquiring insurance against borrower default on substantially all its mortgages. The Company's expected credit loss ["ECL"] impairment analysis considers a range of possible outcomes supported by past loss events, current conditions and an expectation of future possible outcomes.

The allowance for credit losses was identified as a key audit matter due to the number of key data inputs and criteria being assessed as part of the underwriting process. The availability and observability of data inputs and judgmental assumptions are key factors in the susceptibility of the allowance for credit losses being exposed to variances in the probability of default and loss given default. Management judgment was involved in selecting appropriate values for key assumptions, which in the event of a credit loss includes estimates of the amounts recoverable from underlying collateral. In forming their judgement, management had to both assess the effectiveness of their credit management strategies in minimizing future credit losses as well as make a forecast of possible future economic conditions and consider the impact of each on their critical assumptions. Variations in the key assumptions and key data inputs described can have a material effect on the measurement of ECL for each loan underwritten by the Company.

We obtained an understanding of management's controls over exposure to credit risk, including mortgage underwriting policies and processes used to assess borrower capacity, income verification, creditworthiness and collateral. We tested the operating effectiveness of these controls by assessing for a sample of mortgages originated and funded, compliance with management's underwriting policy and processes and eligibility, when arranged, for insurance against borrower default based on criteria of the mortgage default insurer.

For the purpose of auditing the allowance for credit losses, among other procedures,

- We tested the accuracy of the Company's historic default and write-off data and evaluated management's ECL impairment analysis, by obtaining the Company's historical data.
- We tested management's data and model by obtaining contrary data from independent sources, to develop a range for the estimated ECL on the uninsured portfolio of mortgages held at amortized cost.
- We compared our range to management's estimate of allowance for credit losses.
- We also assessed the adequacy of the Company's disclosures on the management of credit risk.

Other information

Management is responsible for the other information. The other information comprises:

- Management's Discussion and Analysis
- The information, other than the consolidated financial statements and our auditor's report thereon, in the Annual Report

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

We obtained Management's Discussion and Analysis prior to the date of this auditor's report. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact in this auditor's report. We have nothing to report in this regard.

The Annual Report is expected to be made available to us after the date of the auditor's report. If, based on the work we will perform on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact to those charged with governance.

Responsibilities of management and those charged with governance for the consolidated financial statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRSs, 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.

In preparing the consolidated financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure, and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Company's audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditor's report is Humayun Jafrani.

Ernst + Young LLP

Chartered Professional Accountants
Licensed Public Accountants

Toronto, Canada
March 1, 2022

Consolidated Statements of Financial Position

As at December 31

[in thousands of Canadian dollars]	Notes	2021	2020
Assets			
Restricted cash	3	**815,807**	669,219
Cash held as collateral for securitization	3	**105,108**	88,206
Accounts receivable and sundry		**97,602**	119,531
Mortgages accumulated for sale or securitization	5	**2,757,640**	2,250,519
Mortgages pledged under securitization	3	**35,435,455**	34,137,421
Deferred placement fees receivable	4	**64,370**	62,535
Mortgage and loan investments	6	**192,340**	213,301
Income taxes recoverable	18	**8,735**	—
Securities purchased under resale agreements	15	**2,677,972**	1,884,811
Other assets	7	**119,129**	62,984
Total assets		**42,274,158**	39,488,527
Liabilities and Equity			
Liabilities			
Bank indebtedness	9	**965,420**	682,832
Obligations related to securities and mortgages sold under repurchase agreements	15	**1,768,029**	1,418,445
Accounts payable and accrued liabilities	16	**222,369**	185,772
Securities sold short	14	**2,677,689**	1,888,049
Debt related to securitized mortgages	10	**35,576,353**	34,265,504
Senior unsecured notes	12	**398,888**	398,554
Income taxes payable	18	**—**	11,470
Deferred income tax liabilities	18	**88,000**	67,100
Total liabilities		**41,696,748**	38,917,726
Common shares	17	**122,671**	122,671
Preferred shares	17	**97,394**	97,394
Retained earnings		**364,974**	383,993
Accumulated other comprehensive loss		**(7,629)**	(33,257)
Total equity		**577,410**	570,801
Total liabilities and equity		**42,274,158**	39,488,527

See accompanying notes

On behalf of the Board:

John Brough
Director

Robert Mitchell
Director

Consolidated Statements of Income

Years ended December 31

[in thousands of Canadian dollars, except earnings per share]	Notes	2021	2020
Revenue			
Interest revenue – securitized mortgages		**793,507**	837,576
Interest expense – securitized mortgages		**(630,279)**	(708,162)
Net interest – securitized mortgages	3	**163,228**	129,414
Placement fees		**303,694**	333,696
Gains on deferred placement fees	4	**16,126**	32,365
Mortgage investment income	6	**63,875**	69,033
Mortgage servicing income		**211,589**	174,979
Realized and unrealized gains (losses) on financial instruments	19	**5,815**	(67,355)
		764,327	672,132
Expenses			
Brokerage fees		**201,786**	159,018
Salaries and benefits		**177,038**	143,503
Interest		**48,909**	53,246
Other operating		**72,773**	57,636
		500,506	413,403
Income before income taxes		**263,821**	258,729
Income tax expense	18	**69,260**	68,500
Net income for the year		**194,561**	190,229
Earnings per share			
Basic	17	**3.20**	3.12

See accompanying notes

Consolidated Statements of Comprehensive Income

Years ended December 31

[in thousands of Canadian dollars]	Notes	2021	2020
Net income for the year		**194,561**	190,229
Other comprehensive income (loss) items that may be subsequently reclassified to income			
Net gains (losses) from change in fair value of cash flow hedges		**31,206**	(73,147)
Reclassification of net losses to income		**3,712**	32,524
		34,918	(40,623)
Income tax recovery (expenses)	18	**(9,290)**	10,800
Total other comprehensive income (loss)		**25,628**	(29,823)
Total comprehensive income		**220,189**	160,406

See accompanying notes

Consolidated Statements of Changes in Equity

Years ended December 31

[in thousands of Canadian dollars]	Common shares	Preferred shares	Retained earnings	Accumulated other comprehensive loss	Total equity
Balance as at January 1, 2021	**122,671**	**97,394**	**383,993**	**(33,257)**	**570,801**
Net income for the year	**—**	**—**	**194,561**	**—**	**194,561**
Other comprehensive income	**—**	**—**	**—**	**25,628**	**25,628**
Dividends paid or declared	**—**	**—**	**(213,580)**	**—**	**(213,580)**
Balance as at December 31, 2021	**122,671**	**97,394**	**364,974**	**(7,629)**	**577,410**

	Common shares	Preferred shares	Retained earnings	Accumulated other comprehensive loss	Total equity
Balance as at January 1, 2020	122,671	97,394	345,029	(3,434)	561,660
Net income for the year	—	—	190,229	—	190,229
Other comprehensive loss	—	—	—	(29,823)	(29,823)
Dividends paid or declared	—	—	(151,265)	—	(151,265)
Balance as at December 31, 2020	122,671	97,394	383,993	(33,257)	570,801

Consolidated Statements of Cash Flows

Years ended December 31

[in thousands of Canadian dollars]	2021	2020
Operating activities		
Net income for the year	**194,561**	190,229
Add (deduct) items		
Deferred income taxes	**11,610**	(4,400)
Non-cash portion of gains on deferred placement fees	**(16,040)**	(31,320)
Decrease (increase) in restricted cash	**(146,588)**	12,377
Net investment in mortgages pledged under securitization	**(1,359,472)**	(2,077,042)
Net increase in debt related to securitized mortgages	**1,372,287**	1,954,756
Securities purchased under resale agreements, net	**(793,161)**	530,024
Securities sold short, net	**855,759**	(621,315)
Amortization of deferred placement fees receivable	**14,205**	10,831
Amortization of property, plant and equipment	**9,182**	7,660
Unrealized losses (gains) on financial instruments	**(37,507)**	63,082
	104,836	34,882
Net change in non-cash working capital balances related to operations	**(507,730)**	(281,946)
Cash used in operating activities	**(402,894)**	(247,064)
Investing activities		
Additions to property, plant and equipment	**(31,956)**	(3,585)
Investment of cash held as collateral for securitization	**(16,902)**	(4,619)
Investment in mortgage and loan investments	**(1,420,147)**	(817,101)
Repayment of mortgage and loan investments	**1,456,265**	971,138
Cash provided by (used in) investing activities	**(12,740)**	145,833
Financing activities		
Dividends paid	**(212,305)**	(150,621)
Obligations related to securities and mortgages sold under repurchase agreements	**349,584**	346,383
Repayment of lease liabilities	**(4,233)**	(3,895)
Issuance of senior unsecured notes	**—**	199,290
Repayment of matured senior unsecured notes	**—**	(175,000)
Cash provided by financing activities	**133,046**	216,157
Net decrease (increase) in bank indebtedness during the year	**(282,588)**	114,926
Bank indebtedness, beginning of year	**(682,832)**	(797,758)
Bank indebtedness, end of year	**(965,420)**	(682,832)
Supplemental cash flow information		
Interest received	**957,742**	999,551
Interest paid	**647,049**	735,830
Income taxes paid	**77,855**	66,194

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[in thousands of Canadian dollars, unless otherwise indicated]

December 31, 2021 and 2020

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 almost $124 billion in mortgages under administration as at December 31, 2021, 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 16 York Street, 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.

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 certain 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 designated as hedged items in fair value hedges, and that would otherwise be carried at amortized cost, are adjusted to record changes in fair value attributable to the risks that are being mitigated in effective hedge relationships. 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 March 1, 2022.

[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 [“GP”, 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. [“FNAM”], and First National Mortgage Corporation.

FNAM is a wholly owned subsidiary of the GP, and an indirect subsidiary of the Company. FNAM is a NHA approved lender and NHA-MBS issuer in the capacity of an “aggregator”. Its business model is to purchase mortgages from mortgage originators in order to create NHA-MBS pools, and subsequently sell these into the Canada Mortgage Bonds programs [“CMB”].

The Company did not consolidate, in its financial statements, four SPEs 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, 2021, the Company recorded, on its consolidated statements of financial position, its portion of the assets of the SPEs amounting to $2,227 million [2020 – $1,565 million]. The Company also recorded, in its consolidated statements of income, interest revenue – securitized mortgages of $55,551 [2020 – $51,141] and interest expense – securitized mortgages of $36,969 [2020 – $39,371] 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 assets and liabilities, equity, income, expenses and cash flows relating to transactions between these companies are eliminated in full 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.

The global pandemic related to an outbreak of COVID-19 has cast additional uncertainty on the assumptions used by management in making its judgements and estimates. Governments and central banks have reacted with significant monetary and fiscal interventions designed to stabilize economic conditions. The duration and impact of the COVID-19 outbreak is unknown at this time, as is the efficacy of the government and central bank interventions. It is not possible to reliably estimate the length and severity of these developments and the impact on the consolidated financial results and condition of the Company and its operating subsidiaries in future periods. Given that the full extent of the impact that COVID-19, including government and/or regulatory responses to the outbreak, will have on the Canadian economy and the Company’s business is highly uncertain and difficult to predict at this time, there is a higher level of uncertainty with respect to management’s judgements and estimates related to the fair value of mortgage and loan investments and the amount of expected credit losses for uninsured residential mortgages.

[d] Significant Accounting Policies

Financial Instruments

The Company accounts for its financial assets and liabilities in accordance with IFRS 9, *Financial Instruments* ["IFRS 9"].

Classification and Measurement of Financial Assets

The Company classifies its financial assets as either amortized cost or at FVTPL as summarized below:

Securities purchased under resale agreements	Amortized cost
Mortgages accumulated for securitization	Amortized cost
Mortgages accumulated for sale	FVTPL
Mortgages pledged under securitization	Amortized cost
Mortgage and loan investments	FVTPL
Deferred placement fees receivable	Amortized cost

Classification and Measurement of Financial Liabilities

The Company classifies its financial liabilities as either amortized cost or at FVTPL as summarized below:

Obligations related to securities and mortgages sold under repurchase agreements	Amortized Cost
Securities sold short	FVTPL
Debt related to securitized mortgages	Amortized cost
Servicing liabilities	Amortized cost
Senior unsecured notes	Amortized cost

Impairment

The expected credit loss ["ECL"] impairment model applies to all debt instruments within financial assets classified as amortized cost or FVOCI, as well as certain off-balance sheet loan commitments. The IFRS 9 ECL approach 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 assesses the credit risk of the mortgages based on the expected repayments of principal and interest. All mortgages with arrears that are less than 31 days past due are included in Stage 1 whereas mortgages with principal in arrears between 31 to 90 days are included in Stage 2. While mortgages in these two stages are not considered to be impaired, the Company recognizes a 12-month ECL for Stage 1 mortgages and a lifetime ECL for Stage 2 mortgages. When a mortgage is in arrears for over 90 days or the Company has issued a legal demand for repayment, there is a specific expectation of a detrimental impact on the estimated cash flows and, therefore, the Company considers the mortgages as impaired and includes them in Stage 3.

The Company's ECL impairment model is built on an unbiased and probability-weighted method, determined by evaluating a range of possible outcomes supported by past loss events and expectation of future possible outcomes, discounted to reflect the time value of money. The key inputs in the measurement of ECL include Probability of Default, Loss Given Default and forecast of future economic conditions, which involve significant judgement.

Hedge accounting

The Company applies IFRS 9 hedge accounting for certain mortgage commitments and funded mortgages.

The Company uses a combination of short Government of Canada bonds and bond repo arrangements to manage exposure to interest rate risk associated with mortgage commitments and funded mortgages held prior to securitization. In addition, the Company uses interest rate swaps to manage exposure to interest rate risk for mortgages in SPEs. The Company documents a hedging relationship between the hedging instrument and the hedged item at inception when the relationship is established. The Company also assesses the effectiveness of the hedges at both the hedge inception and on an ongoing basis. Any ineffectiveness of any hedging relationship is recognized immediately in the consolidated statements of income.

Cash flow hedges

The Company applies cash flow hedge accounting for the anticipated funding of its multi-unit residential commercial segment mortgages. At the time of mortgage commitment, the Company shorts Government of Canada bonds as the hedging instrument to hedge the cash flows on the anticipated future debt to be arranged through securitization of these mortgages obtained through CMB, disclosed as debt related to securitized mortgages. The Company also uses the same hedging strategy when placing mortgages with institutional investors who plan to use CMB funding. The effective portion of the change in the fair value of the designated hedging instrument qualifying as a cash flow hedge is recognized in other comprehensive income ["OCI"] in the consolidated statements of comprehensive income. When the hedge relationship is terminated, the cumulative amounts recognized in OCI are amortized into interest expense – securitized mortgages over the term of the securitized debt, or amortized against placement fees from institutional investors. Any change in fair value of the hedge determined as ineffective is recognized immediately in the consolidated statements of income.

Fair value hedges

The Company enters into interest rate swaps to protect against changes in the fair value of fixed rate mortgages funded by ABCP debt. The Company also shorts Government of Canada bonds to manage interest rate exposure for a portion of single-family mortgage commitments and funded residential mortgages accumulated for securitization. The Company applies hedge accounting for the swaps. For the short bond hedges, the Company documents a hedging relationship during the period when the mortgages are funded until the date they are securitized or placed with an arm's length investor. The Company does not apply hedge accounting to the short bonds used to mitigate interest risk on single-family mortgage commitments. The Company's policy is not to utilize derivative financial instruments for trading or speculative purposes.

In the case of the swaps and short bonds used to hedge funded mortgages, changes in fair value of the hedged item, to the extent that the hedging relationship is effective, are offset by changes in the fair value of the hedging instrument, both of which are recognized in the consolidated statements of income. At hedge unwind, the realized change in the value of the hedging instrument is 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 fair value of an ineffective hedge is immediately recorded in the consolidated statements of income.

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 the mortgages it has originated. 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 the 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.

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 market 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 two large Canadian banks through the mortgage broker distribution channel. The Company recognizes servicing income when the services are rendered and the underwritten mortgages have been 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 mortgages placed with institutional investors are expensed as incurred, and those relating to mortgages recorded at amortized cost are capitalized to the carrying cost of the related mortgages and amortized over the term of the mortgages.

Mortgages pledged under securitization

Mortgages pledged under securitization are mortgages that the Company has originated and funded with debt raised through the securitization markets, and have been classified at amortized cost. The Company has a continuous involvement in these mortgages, including the right to receive future cash flows arising from these mortgages. 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.

Debt related to securitized 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.

Mortgages accumulated for sale or securitization

Mortgages accumulated for sale are mortgages funded pending subsequent settlement with institutional investors and are classified as FVTPL and recorded at fair value. These mortgages are held for terms usually not exceeding 90 days.

Mortgages accumulated for securitization are mortgages funded pending the arrangement of term debt through the Company's various securitization programs and are measured 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 non-derivative financial assets with fixed or determinable payments, and are classified as FVTPL. The mortgages are measured at management's best estimate of the net realizable value. Changes in fair value are recognized immediately in the consolidated statements of income.

Leases

The Company measures right-of-use assets at cost. The right-of-use assets are subsequently amortized using the straight-line method. The right-of-use assets are also subject to impairment. Lease liabilities are calculated using the present value of future lease payments, discounted at the Company's incremental borrowing rate. After the commencement date, the amount of lease liabilities is increased to reflect the accretion of interest and reduced for the lease payments made.

The Company's major leases are for premises at its Toronto head office and four regional offices. The Company has elected not to recognize right-of-use assets and a lease liability for its various office equipment leases, which are insignificant for application of the standard.

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 certain computer licenses, which are straight-line over useful lives

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 Company'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.

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 loans net of cash balances or deposit 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. The liability represents the portion of the upfront fee required to earn a market rate of servicing over the related mortgage term. This is similar to the method which 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 or tax recoverable amounts 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.

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 CMB. In these securitizations, the Company transfers the assets to structured entities for cash, and incurs interest-bearing obligations typically matched to the term of the mortgages. These securitizations do not qualify for derecognition, although the structured entities 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. 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 structured entities 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, 2021, the cash held as collateral for securitization was $105,108 [2020 – $88,206].

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

	2021	
	Carrying amount of securitized mortgages ($)	**Carrying amount of associated liabilities ($)**
Securitized mortgages	**35,186,217**	**(35,659,675)**
Capitalized amounts related to hedge accounting	**50,880**	**(46,933)**
Capitalized origination costs	**198,358**	**—**
Debt discounts	**—**	**130,255**
	35,435,455	**(35,576,353)**
Add	**—**	**—**
Principal portion of payments recorded in restricted cash	**766,118**	**—**
	36,201,573	**(35,576,353)**

	2020	
	Carrying amount of securitized mortgages ($)	**Carrying amount of associated liabilities ($)**
Securitized mortgages	33,827,022	(34,231,557)
Capitalized amounts related to hedge accounting	125,581	(108,372)
Capitalized origination costs	184,818	—
Debt discounts	—	74,425
	34,137,421	(34,265,504)
Add	—	—
Principal portion of payments recorded in restricted cash	612,742	—
	34,750,163	(34,265,504)

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.

Mortgages pledged under securitization have been classified as amortized cost and are carried at par plus adjustment for unamortized origination costs and amounts related to hedge accounting.

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

	2021	2020
Opening balance, January 1	**184,818**	175,702
Add: new origination costs capitalized in the year	**114,789**	95,849
Less: amortization in the year	**(101,249)**	(86,733)
Ending balance, December 31	**$198,358**	$184,818

During the year ended December 31, 2021, the Company invested in mortgages that were transferred into the securitization vehicles with principal balances as at December 31, 2021 of $8,940,445 [2020 – $7,638,054].

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

2022	5,737,486
2023	5,233,694
2024	5,056,830
2025	7,039,026
2026 and thereafter	12,119,181
	$35,186,217

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

	2021	2022
Arrears days		
31 to 60	**1,086**	4,555
61 to 90	**447**	1,946
Greater than 90	**752**	4,050
	$2,285	$10,551

All the mortgages pledged under securitization in arrears are insured, except for six mortgages which are uninsured and have a total principal balance of $1,505 as at December 31, 2021 [2020 – nine mortgages, $2,572]. The Company's exposure to credit loss is limited to uninsured mortgages with principal balances totaling $3,094,301 [2020 – $2,312,549], before consideration of the value of underlying collateral. The majority of such mortgages are conventional prime single-family mortgages, with an 80% or less loan to value ratio at origination, and verified borrower income. The Company has provided an allowance of $766 for the year ended December 31, 2021 [2020 – $862].

In order to assist its borrowers during the COVID-19 pandemic, in the first quarter of 2020, the Company started providing up to three months of payment deferrals to all single-family mortgagors applying for payment relief because of temporary hardship resulting from the pandemic. In the second and third quarters, the Company granted extensions to the original three months period to qualified borrowers based on additional due diligence. The payment deferral program ended September 30, 2020. Interest continues to accrue on these mortgages and the interest otherwise collectible is capitalized to the mortgage's principal. As the deferral is provided temporarily in keeping with a larger industry wide relief program, the Company does not consider these mortgages to be in arrears for ECL disclosure purposes.

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 make payments when due.

Deferred placement fees receivable is classified as amortized cost, and has been calculated initially based on the present value of the anticipated future stream of placement fees. 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 the value of its investment in the mortgage. The effect of variations, if any, between actual experience and assumptions will be recorded in future consolidated statements of income but is expected to be minimal.

2021

	Residential ($)	Commercial ($)	Total ($)
Mortgages placed with institutional investors	1,018,328	2,421,410	3,439,738
Gains on deferred placement fees created	1,442	14,684	16,126
Cash receipts on deferred placement fees received	97	16,775	16,872

2020

	Residential ($)	Commercial ($)	Total ($)
Mortgages placed with institutional investors	—	3,461,154	3,461,154
Gains on deferred placement fees created	—	32,365	32,365
Cash receipts on deferred placement fees received	—	13,008	13,008

The Company estimates that the expected undiscounted cash flows to be received on the deferred placement fees receivable will be as follows:

	2022	2023	2024	2025	2026 and thereafter	Total
Residential	427	361	305	257	126	1,476
Commercial	15,449	13,534	11,685	9,520	21,080	71,268
	$15,876	**$13,895**	**$11,990**	**$9,777**	**$21,206**	**$72,744**

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 in advance of settlement with institutional investors.

Mortgages originated for the Company's own securitization programs are classified as amortized cost and are recorded at par plus adjustment for unamortized origination costs. 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 as the time period between origination and sale is short. The following table summarizes the components of mortgages according to their classification:

	2021	2020
Mortgages accumulated for securitization	**2,726,697**	2,200,484
Mortgages accumulated for sale	**30,943**	50,035
	$2,757,640	$2,250,519

The Company's exposure to credit loss is limited to $299,446 [2020 – $216,667] of principal balances of uninsured mortgages within mortgages accumulated for securitization, before consideration of the value of underlying collateral. As at December 31, 2021, none of these mortgages is in arrears past 31 days. These are primarily conventional prime single-family mortgages similar to the mortgages described in note 3. Accordingly, the expected credit loss related to these mortgages is insignificant.

6. Mortgage and loan investments

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 are measured at FVTPL, and are recorded on a fair value basis. Any changes in fair value are immediately recognized in income. The Company recorded a loss of $730 [2020 – $3,076] for the year ended December 31, 2021.

The following table discloses the composition of the Company's portfolio of mortgage and loan investments by geographic region as at December 31, 2021:

Province/Territory	Portfolio balance	Percentage of portfolio
Alberta	**6,210**	3.23
British Columbia	**44,578**	23.18
Manitoba	**3,460**	1.80
New Brunswick	**504**	0.26
Newfoundland and Labrador	**152**	0.08
Nova Scotia	**765**	0.40
Nunavut	**40**	0.02
Ontario	**114,386**	59.46
Prince Edward Island	**237**	0.12
Quebec	**21,639**	11.25
Saskatchewan	**203**	0.11
Yukon	**166**	0.09
	$192,340	100.00%

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

	2021	2020
Arrears days		
31 to 60	**884**	5,363
61 to 90	**397**	112
Greater than 90	**14,015**	33,666
	$15,296	$39,141

The portfolio contains $12,723 [December 31, 2020 – $5,544] of insured mortgages and $179,617 [December 31, 2020 – $207,757] of uninsured mortgage and loan investments as at December 31, 2021. Of the uninsured mortgages, approximately $10,712 [December 31, 2020 – $34,738] have principal balances in arrears of more than 30 days. One of these mortgages is non-performing and the Company has stopped accruing interest. This mortgage currently has a nil carrying value as at December 31, 2021. The mortgage had an original principal balance of $13,605 [December 31, 2020 – three mortgages, original principal balance of $38,423, and fair value of $9,655].

The maturity profile of the principal amount of the loans in the table below is based on the earlier of contractual renewal or maturity dates:

						2021	2020
	2022	2023	2024	2025	2026 and thereafter	Total	Total
Residential	**37,266**	**2,081**	**2,774**	**10,545**	**16,016**	**68,682**	75,280
Commercial	**92,506**	**21,765**	**22,832**	**167**	**—**	**137,270**	166,790
	$129,772	**$23,846**	**$25,606**	**$10,712**	**$16,016**	**$205,952**	$242,070

Interest income earned for the year was $14,292 [2020 – $14,337] and is included in mortgage investment income on the consolidated statements of income.

7. Other assets

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

	2021	2020
Property, plant and equipment, net	**36,968**	10,483
Right-of-use assets	**52,385**	22,725
Goodwill	**29,776**	29,776
	$119,129	$62,984

The right-of-use assets pertain to five premises leases for the Company's office space. The leases have remaining terms of one to fifteen years. The related lease liability of $52,871 as at December 31, 2021 [2020 – $22,922] is grouped with accounts payable and accrued liabilities on the consolidated statements of financial position.

The recoverable amount of the Company's goodwill is calculated by reference to the Company's market capitalization, mortgages under administration, origination volume, and profitability. These factors indicate that the Company's recoverable amount exceeds the carrying value of its net assets and, accordingly, goodwill is not impaired.

8. Mortgages Under Administration

As at December 31, 2021, the Company managed mortgages under administration of $123,907,627 [2020 – $118,723,990], 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, 2021, the Company administered 325,399 mortgages [2020 – 342,871] for 119 institutional investors [2020 – 105] with an average remaining term to maturity of 43 months [2020 – 42 months].

Mortgages under administration are serviced as follows:

	2021	2020
Institutional investors	**84,184,863**	80,725,722
Mortgages accumulated for sale or securitization and mortgage and loan investments	**2,969,617**	2,495,926
Mortgages pledged under securitization	**35,186,217**	33,827,022
CMBS conduits	**1,566,930**	1,675,320
	$123,907,627	$118,723,990

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.

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, 2021 was $806,268 [2020 – $852,361]. As at December 31, 2021, the Company has included in accounts receivable and sundry $702 [2020 – $374] of uninsured non-performing mortgages.

9. Bank indebtedness

Bank indebtedness includes a revolving credit facility of $1,500,000 [2020 – $1,250,000] maturing in March 2026. At December 31, 2021, $965,420 [2020 – $682,832] was drawn, of 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.

10. Debt related to securitized mortgages

Debt related to securitized mortgages represents the funding for mortgages pledged under the NHA-MBS, CMB and ABCP programs. As at December 31, 2021, debt related to securitized mortgages was $35,576,353 [2020 – $34,265,504], net of unamortized discounts of $130,255 [2020 – $74,425]. A comparison of the carrying amounts of the pledged mortgages and the related debt is summarized in note 3.

Debt related to securitized 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.

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 mortgages pledged under securitization. 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 outstanding as at December 31, 2021 and 2020:

2021

	Less than 3 years	3 to 5 years	6 to 10 years	Total notional amount	Fair value
Interest rate swap contracts	**$2,403,943**	**$990,683**	**—**	**$3,394,626**	**$17,444**

2020

	Less than 3 years	3 to 5 years	6 to 10 years	Total notional amount	Fair value
Interest rate swap contracts	$2,634,822	$1,102,126	$44,983	$3,781,931	$(35,163)

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

12. Senior unsecured notes

The Company has two note issuances outstanding. $200 million of five year term Series 2 senior unsecured notes bearing interest at 3.582% payable in equal semi-annual payments maturing in November 2024. $200 million of five year Series 3 senior unsecured notes bearing interest at 2.961% payable in equal semi-annual payments maturing in November 2025.

13. Commitments, guarantees and contingencies

The Company's commitments for premises listed above have remaining terms of one to fifteen years, and have been accounted in right-of-use assets and recorded as other assets on the consolidated statements of financial position.

Outstanding commitments for future advances on mortgages with terms of one to 10 years amounted to $1,939,420 as at December 31, 2021 [2020 – $2,456,591]. 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.

As at December 31, 2021, the Company has the following operating lease commitments for its office premises:

2022	10,339
2023	9,840
2024	9,126
2025 and thereafter	105,121
	$134,426

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.

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, 2022.

16. Accounts payable and accrued liabilities

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

	2021	2020
Accrued liabilities	**72,508**	70,514
Accrued dividends payable	**12,427**	11,153
Accrued interest on securitization debt	**46,763**	51,187
Servicing liability	**37,800**	29,996
Lease liability	**52,871**	22,922
	$222,369	$185,772

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, 2021 and 2020

	#	$
Common shares	**59,967,429**	**$122,671**
Preferred shares	**4,000,000**	**$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 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. On March 31, 2021, 399,700 of the outstanding Series 1 Preference Shares were tendered for conversion, on a one-for-one basis, into Series 2 Preference Shares, while 497,388 of the outstanding Series 2 Preference Shares were tendered for conversion, on a one-for-one basis, into Series 1 Preference Shares. As at December 31, 2021, there were 2,984,835 Series 1 Preferred Shares [2020 – 2,887,147] and 1,015,165 Series 2 Preferred Shares [2020 – 1,112,853] outstanding with an aggregate carrying value of $97,394.

Holders of the Class A Series 1 Preferred Shares receive a cumulative quarterly fixed dividend at a rate equal to the five-year Government of Canada yield plus 2.07%. The dividend rate may be reset every five years, as and when approved by the Board of Directors. The current dividend rate on the Class A Series 1 Preferred Shares is 2.895% annually for a new five-year term ending March 31, 2026.

Holders of the Class A 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.

Both classes of preferred shares do not have voting rights, are redeemable only at the option of the Company, and are therefore classified as equity. The par value per preferred share is $25.

[d] Earnings per Share

	2021 $	2020 $
Net income attributable to shareholders	**194,561**	190,229
Less: dividends declared on preferred shares	**(2,695)**	(2,846)
Net income attributable to common shareholders	**191,866**	187,383
Number of common shares outstanding	**59,967,429**	59,967,429
Basic earnings per common share	**3.20**	3.12

18. Income taxes

The major components of deferred provision for (recovery of) income taxes for the years ended December 31 consist of the following:

	2021	2020
Related to origination and reversal of temporary differences	**11,610**	(3,971)
Decrease in future tax rates	**—**	(429)
	$11,610	$(4,400)

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

	2021	2020
Income taxes relating to the current year	**57,650**	72,800
Income taxes related to the prior year	**—**	100
	$57,650	$72,900

The effective income tax rate reported in the consolidated statements of income varies from the Canadian tax rate of 26.42% for the year ended December 31, 2021 [2020 – 26.47%] for the following reasons:

	2021	2020
Company's Statutory Tax Rate	**26.42%**	26.47%
Income before income taxes	**263,821**	258,729
Income tax at statutory tax rate	**69,702**	68,486
Increase (decrease) resulting from		
Permanent differences	**193**	200
Changes in future tax rates	**—**	(429)
Prior year adjustment	**(457)**	100
Other	**(178)**	143
Income Tax Expense	**$69,260**	$68,500

The movement in significant components of the Company's deferred income tax liabilities and assets for the years ended December 31, 2021 and 2020 are as follows:

	As at January 1, 2021	Recognized in income and OCI	As at December 31, 2021
Deferred Income Tax			
Deferred placement fees receivable	16,553	454	17,007
Deferred costs - securitization	67,890	16,996	84,886
Carrying values of mortgages pledged under securitization in excess of tax values	2,629	(2,445)	184
Other	811	2,711	3,522
Right-of-use asset	6,015	7,825	13,840
Lease liability	(6,067)	(7,901)	(13,968)
Unrealized gains on interest rate swaps	(2,863)	981	(1,882)
Cumulative eligible capital property	(3,662)	263	(3,399)
Servicing liability	(7,940)	(2,047)	(9,987)
Fair value adjustments not deducted for tax purposes	(6,266)	4,063	(2,203)
Total	**$67,100**	**$20,900**	**$88,000**

	As at January 1, 2020	Recognized in income and OCI	As at December 31, 2020
Deferred Income Tax			
Deferred placement fees receivable	11,189	5,364	16,553
Deferred costs - securitization	72,749	(4,859)	67,890
Unrealized gains on interest rate swaps	13,354	(16,217)	(2,863)
Other	505	306	811
Right-of-use asset	1,933	4,082	6,015
Lease liability	(1,987)	(4,080)	(6,067)
Carrying values of mortgages pledged under securitization in excess of tax values	(581)	3,210	2,629
Cumulative eligible capital property	(3,958)	296	(3,662)
Servicing liability	(5,577)	(2,363)	(7,940)
Fair value adjustments not deducted for tax purposes	(5,327)	(939)	(6,266)
Total	**$82,300**	**$(15,200)**	**$67,100**

The amount of deferred tax expense recorded in income and OCI consists of an expense of $11,610 [2020 – recovery of $4,400] recorded in net income and an expense of $9,290 [2020 – recovery of $10,800] recorded in OCI related to unrealized losses on cash flow hedges.

The calculation of taxable income of the Company is based on estimates and the interpretation of 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 income tax balances and the change could be significant.

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 is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company's exposure to the risk of changes in market interest rates relates primarily to the Company's mortgages accumulated for securitization.

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 2021 and 2020.

	Decrease in interest rate[1]		Increase in interest rate	
	2021	**2020**	**2021**	**2020**
100 Basis Point Shift				
Impact on net income	**$13,180**	$4,255	**$(7,959)**	$(4,255)
200 Basis Point Shift				
Impact on net income	**$29,760**	$15,995	**$(15,919)**	$(8,511)

[1] Interest rate is not decreased 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. As at December 31, 2021, 91% [2020 – 93%] of the pledged mortgages were insured mortgages. 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, [v] accounts receivable and sundry, and [vi] mortgage and loan investments. The Company has a credit facility with a syndicate of financial institutions, which provides for a total of $1,500,000 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 19.6% [2020 – 13.1%] 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] Mortgages and loan investments

Mortgages and loan investments are measured at FVTPL. The fair value of these mortgages is based on non-observable inputs, and is measured at management's best estimate of the net realizable value.

[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.

[c] Securities owned and sold short

The fair values of securities owned and sold short used by the Company to hedge its interest rate exposure are determined by quoted prices on a secondary market.

[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 expected future cost related to the servicing of 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 mortgages accumulated for sale, cash held as collateral for securitization, restricted cash and bank indebtedness correspond to the respective outstanding amounts due to their short-term maturity profiles.

[f] Fair value of financial instruments not carried at fair value

The fair value of these financial instruments are determined by discounting projected cash flows using market industry pricing practices, including the rate of unscheduled prepayment. 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. These fair values are estimated using valuation techniques in which one or more significant inputs are unobservable [Level 3], and are calculated for disclosure purposes only.

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 $35,435,455 [2020 – $34,137,421] and a fair value of $36,515,923 [2020 – $36,212,226]; debt related to securitized mortgages, which has a carrying value of $35,576,353 [2020 – $34,265,504] and a fair value of $35,864,253 [2020 – $34,909,488]; and senior unsecured notes, which have a carrying value of $398,888 [2020 – $398,554] and a fair value of $409,056 [2020 – $412,786]. 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:

2021

	Level 1	Level 2	Level 3	Total
Financial Assets				
Mortgages accumulated for sale	—	30,943	—	30,943
Mortgage and loan investments	—	—	192,340	192,340
Interest rate swaps	—	688	—	688
Total Financial Assets	—	$31,631	$192,340	$223,971
Financial Liabilities				
Securities sold short	—	2,677,689	—	2,677,689
Total Financial Liabilities	—	$2,677,689	—	$2,677,689

2020

	Level 1	Level 2	Level 3	Total
Financial Assets				
Mortgages accumulated for sale	—	50,035	—	50,035
Mortgage and loan investments	—	—	213,301	213,301
Interest rate swaps	—	21,109	—	21,109
Total Financial Assets	—	$71,144	$213,301	$284,445
Financial Liabilities				
Securities sold short	—	1,888,049	—	1,888,049
Total Financial Liabilities	—	$1,888,049	—	$1,888,049

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, 2021 that was estimated using a valuation technique based on assumptions that are not fully supported by observable market prices or rates was approximately a gain of $15,157 [2020 – loss of $3,076]. 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 2021 and 2020, the Company did not have any transfers between levels.

The following table presents changes in the fair values, including realized gains of $10,666 [2020 – losses of $112,015] of the Company's financial assets and financial liabilities for the years ended December 31, 2021 and 2020, all of which have been classified as FVTPL:

	2021	2020
FVTPL mortgages	**(730)**	(3,076)
Securities sold short	**15,397**	(75,689)
Interest rate swaps	**(8,852)**	11,410
	$5,815	$(67,355)

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, 2021 and 2020. 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, 2021	Investments	Losses recorded in income	Payment and amortization	Fair value as at December 31, 2021
Financial Assets					
Mortgage and loan investments	**$213,301**	**$608,109**	**$(730)**	**$(628,340)**	**$192,340**

	Fair value as at January 1, 2020	Investments	Unrealized losses recorded in income	Payment and amortization	Fair value as at December 31, 2020
Financial Assets					
Mortgage and loan investments	$370,414	$130,165	$(3,076)	$(284,202)	$213,301

Following the financial crisis, the reform and replacement of benchmark interest rates such as CDOR and other interbank offered rates ["IBORs"] became a priority for global regulators. The Canadian Alternative Reference Rate Working Group ["CARR"] was created to identify and seek to develop a new risk-free Canadian dollar interest rate benchmark. An enhanced Canadian Oversight Repo Rate Average ["CORRA"] has been designed to comply with recommendations of the Financial Stability Board as part of a global effort to reform benchmark interest rates. There is some uncertainty about how the Canadian dollar benchmark rates will evolve and the speed at which CORRA will become a dominant benchmark for Canadian dollar borrowings. For NHA MBS purposes, CMHC announced that pools with a reference rate based on CDOR will transition to CORRA based securities on May 1, 2022. The Company has many swaps and other derivatives that are referenced to CDOR. All of these instruments are with large Canadian financial instruments and the Company will rely on those institutions to amend the agreements as required to incorporate the new reference rate. The Company believe this transition will have only a small, if any, impact of the Company's operations.

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 common share capital and retained earnings. FNFLP 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, 2021, the ratio was 2.21:1 [2020 – 1.77:1]. The Company was in compliance with the bank covenant throughout the year.

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.

2021

	Residential	Commercial	Total
Revenue			
Interest revenue – securitized mortgages	538,317	255,190	793,507
Interest expense – securitized mortgages	(422,707)	(207,572)	(630,279)
Net interest – securitized mortgages	115,610	47,618	163,228
Placement and servicing	444,658	86,751	531,409
Mortgage investment income *[note 6]*	41,050	22,825	63,875
Realized and unrealized gains (losses) on financial instruments	6,525	(710)	5,815
	$607,843	**$156,484**	**$764,327**
Expenses			
Amortization	8,065	1,117	9,182
Interest	37,476	11,433	48,909
Other operating	362,936	79,479	442,415
	$408,477	**$92,029**	**$500,506**
Income Before Income Taxes	$199,366	$64,455	$263,821
Identifiable assets	28,813,695	13,430,687	42,244,382
Goodwill	—	—	29,776
Total Assets	**$28,813,695**	**$13,430,687**	**$42,274,158**
Capital Expenditures	**$22,380**	**$9,576**	**$31,956**

2020

	Residential	Commercial	Total
Revenue			
Interest revenue – securitized mortgages	592,641	244,935	837,576
Interest expense – securitized mortgages	(507,187)	(200,975)	(708,162)
Net interest – securitized mortgages	85,454	43,960	129,414
Placement and servicing	400,506	140,534	541,040
Mortgage investment income *[note 6]*	47,111	21,922	69,033
Realized and unrealized losses on financial instruments	(64,279)	(3,076)	(67,355)
	$468,792	$203,340	$672,132
Expenses			
Amortization	7,118	542	7,660
Interest	40,736	12,510	53,246
Other operating	279,853	72,644	352,497
	$327,707	$85,696	$413,403
Income Before Income Taxes	$141,085	$117,644	$258,729
Identifiable assets	28,945,884	10,512,867	39,458,751
Goodwill	—	—	29,776
Total Assets	$28,945,884	$10,512,867	$39,488,527
Capital Expenditures	$2,510	$1,075	$3,585

22. Related party and other transactions

The Company has servicing contracts in connection with commercial mezzanine mortgages originated by the Company and 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 $119,005 of new mortgages for the related parties. The related parties also funded several progress draws totaling $22,360 on existing mortgages originated by the Company. All such mortgages, which are administered by the Company, have a balance of $213,648 as at December 31, 2021 [December 31, 2020 – $179,320]. As at December 31, 2021, two 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 by the Company in 2021 was $1,966 [2020 – $3,212], net of third-party investor reimbursement.

A senior executive and shareholder of the Company has a significant investment in a Canadian bank. In the first quarter of 2021, the Company entered into an agreement to originate and adjudicate applications for secured credit cards for the bank. These applications are originated from the Company's mortgage broker relationships. The Company receives a fee for successfully adjudicating such credit.

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, shareholders and employees — and are the basis of our 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 Ethics and Conduct Policy, a Whistleblower Policy and an Insider Trading Policy. These policies follow the corporate governance guidelines of Canadian securities regulators. As a public company, First National's Board continues to update, develop and implement appropriate governance policies and practices as appropriate.

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 National Instrument 58-101 – Disclosure of Corporate Governance Practices.

Committee Members
Barbara Palk (Chair), Duncan Jackman and Robert Pearce

BOARD OF DIRECTORS

Stephen Smith

Stephen Smith, one of Canada's leading financial services entrepreneurs, is the Executive Chairman 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.

From 2006 to January 12, 2022, Mr. Smith was Chief Executive Officer of First National Financial Corporation.

Mr. Smith is Chairman of Canada Guaranty Mortgage Insurance Company, which he owns in partnership with Ontario Teachers' Pension Plan. He is Chairman and co-owner of Duo Bank of Canada, formerly Walmart Canada Bank, whose subsidiary Fairstone Financial Inc., is Canada's largest non-bank consumer finance lender. Mr. Smith is the largest shareholder in Equitable Bank, Canada's Challenger Bank™. He is also Chairman of Peloton Capital Management, a North American focused private equity firm. Mr. Smith is a member of the board of directors of the C.D. Howe Institute, E-L Financial Corporation Limited and the Canada Infrastructure Bank. He is also Chairman of Historica Canada, which produces the Heritage Minutes and publishes The Canadian Encyclopedia. In 2019, Mr. Smith was inducted into the Canadian Business Hall of Fame.

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 Bachelor of Science (Honours) in Electrical Engineering from Queen's University and an M.Sc. in Economics from the London School of Economics.

Moray Tawse

Moray Tawse is Executive Vice President and Secretary of the Corporation, and Executive Vice President 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.

Jason Ellis (effective January 12, 2022)

Jason Ellis is the President and Chief Executive Officer for First National and is responsible for the design and maintenance of strategy and operational excellence across the organization. Mr. Ellis joined First National in 2004 as Director, Capital Markets responsible for leading First National's capital markets' activities, including interest rate risk management, funding, and securitization for all commercial and residential mortgage origination. Mr. Ellis was appointed Chief Operating Officer in 2018 and President in 2019. On January 12, 2022, Mr. Ellis was appointed Chief Executive Officer. Prior to joining First National in 2004, Mr. Ellis was with the Asset/Liability Management group at Manulife Financial and with RBC Dominion Securities in Toronto and New York where he traded fixed income and interest rate derivatives. Mr. Ellis holds a BA degree from the University of Western Ontario, an MBA degree from McMaster University and is a CFA charterholder.

John Brough

John Brough is an executive with over 40 years of experience in the real estate industry. Mr. Brough was President of both Torwest, Inc. and Wittington Properties Limited, real estate development companies, from 1998 to December 31, 2007. Prior thereto, from 1996 to 1998, Mr. Brough was Executive Vice President and Chief Financial Officer of iSTAR Internet, Inc. 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 he held from 1986 to 1996. He is currently a director and Chairman of the Audit Committee of Wheaton Precious Metals Corp. Mr. Brough was formerly a director and Chairman of the Audit Committee of Canadian Real Estate Investment Trust from 2008 to 2018. Mr. Brough was formerly a director and Chair of the Audit and Risk Committee of Kinross Gold Corporation from 1994 to 2020. 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, Chartered Professional Accountants of Ontario and Chartered Professional Accountants of Canada.

Duncan Jackman

Duncan Jackman has been Chairman, President and Chief Executive Officer of E-L Financial Corporation, an investment and insurance holding company, since 2003. In 2003, he was also elected Chairman of the board of directors of The Empire Life Insurance Company. Mr. Jackman is also Chairman of Algoma Central Corporation, the largest Great Lakes bulk shipper, as well as Chairman and President of Economic Investment Trust Limited and United Corporations Limited, two Canadian listed closed-end funds. He also serves as a member of the board of directors of several other public and private companies. Mr. Jackman is a member of the Business Council of Canada and formerly served on the Economic Advisory Council to the Minister of Finance, Government of Canada. He is also Chair of the Patron's Council for Community Living Toronto, which provides support to thousands of individuals with an intellectual disability. Mr. Jackman graduated from McGill University in Montreal.

Robert Mitchell

Robert Mitchell was appointed Executive Chair and Chair of the Investment Committee of Dixon Mitchell Investment Canada Inc., a Vancouver-based investment management company, on January 1, 2021. From 2000 to 2020, he was President of Dixon Mitchell Investment Counsel Inc. Prior to that, he was Vice President, Investments at Seaboard Life Insurance Company. Mr. Mitchell has an MBA from the University of Western Ontario and 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

Barbara 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 board of directors of Crombie Real Estate Investment Trust, where she chairs the Human Resources Committee. Her experience on boards of directors include the Ontario Teachers' Pension Plan, where she chaired the Investment Committee; TD Asset Management USA Funds Inc.; Canadian Coalition for Good Governance, where she chaired the Governance Committee; 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) in Economics 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, CPI Card Group and Duo Bank of Canada. 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 an MBA from the University of British Columbia. Mr. Pearce brings over 40 years of operational and leadership experience in the financial services industry to the Board of Directors.

STAKEHOLDER INFORMATION

Corporate Address

First National Financial Corporation
16 York Street, Suite 1900
Toronto, Ontario M5J 0E6
Phone: 416.593.1100
Fax: 416.593.1900

Investor Relations Website

www.firstnational.ca

Annual Meeting

May 5, 2022, 9:30 a.m. EDT
Virtually as provided
by Computershare Investor Services Inc.

https://meetnow.global/MVHWATC

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

Investor Relations Contacts

Robert Inglis
Chief Financial Officer
rob.inglis@firstnational.ca

Ernie Stapleton
President, Fundamental
ernie@fundamental.ca

Auditors

Ernst & Young LLP, Toronto, Ontario

Legal Counsel

Stikeman Elliott LLP, Toronto, Ontario

Senior Executives of First National Financial Corporation

Stephen Smith
Co-founder, Executive Chairman

Moray Tawse
Co-founder and Executive Vice President

Jason Ellis
President and Chief Executive Officer

Robert Inglis
Chief Financial Officer

Thomas Kim
Senior Vice President and Managing Director, Capital Markets

Scott McKenzie
Senior Vice President, Residential Mortgages

Jeremy Wedgbury
Senior Vice President, Commercial Mortgages

Hilda Wong
Senior Vice President and General Counsel

Vancouver

Calgary

Toronto

Montreal

Halifax