LEAGUE SAVINGS AND MORTGAGE

*A Credit Union Company*

# annual REPORT 2012

LEAGUE SAVINGS
AND MORTGAGE
*A Credit Union Company*

## Table of Contents


| | |
|---|---|
| Vision, Mission and Values | 2 |
| Message from the Board of Directors | 3 |
| Message from the President & Chief Executive Officer | 5 |
| Management Discussion and Analysis | 7 |
| Financial Statements | 11 |
| Corporate Governance | 43 |


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# Vision, Mission and Values

## Vision

League Savings and Mortgage Company supports credit unions in being the preferred provider of financial solutions.

## Mission

To strengthen credit union capacity for success.

## Values

*Leadership*
We will provide leadership to the credit union system.

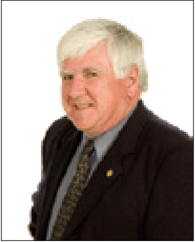
*Stewardship*
We accept the roles of support and leadership defined for us by the credit unions, and with them, support the well-being of the credit union system and the communities it serves. We will operate in a socially responsible and profitable manner for the common good of our stakeholders.

*Service*
We are committed to providing professional service to our stakeholders, who include credit unions and their employees, our affiliates and their employees, and to each other.

*Respect*
We will conduct ourselves respectfully – respectful of diversity, respectful of ourselves and respectful of others in order to build and sustain a productive workplace.

*Accountability*
We choose to be accountable for our actions and the results we deliver to our stakeholders. We share responsibility for the well-being and success of League Savings and Mortgage Company and the credit unions it serves.

*Continuous Growth and Development*
We commit to continually strengthening our organization and services. We will initiate learning and improve personally, departmentally and corporately to enhance our contributions for the well-being of our stakeholders and the communities we serve.



Recognizing the challenges the Atlantic credit union system faces, League Savings and Mortgage Company's primary focus in 2012 was on improving credit union competiveness around mortgage and deposit products. Improved pricing was provided to credit unions through the new Market Rate Mortgage and Deposit Programs. In addition, the implementation of the Mortgage-Backed Securities (MBS) program will provide another competitively priced funding option that will enable the Atlantic credit union system to grow our share of the mortgage market. There is no doubt that this increased focus on competitive pricing will have an impact on League Savings and Mortgage Company's future profitability and future returns to credit unions. However, the Board is confident that improving the competitive position of our system will result in improved market share and greater profitability for the entire system over the longer term.

The mortgage and deposit market has traditionally been a very competitive environment in which to succeed, and 2012 was no exception. Changes to mortgage lending regulations at the federal level significantly impacted the consumer's ability to borrow against their home and continued emphasis on high levels of household debt are expected to slow growth in the mortgage market in the future. In this new, more challenging environment, institutions cannot depend on growth in the mortgage market to build their balance sheet, and will instead need to take market share from their competitors. To succeed in the future, credit unions will need competitive products and services priced to attract and retain member business. This message was clearly heard throughout the Role and Relationship Committee's consultation process and figured prominently in the Board of Director's discussions on the future direction of League Savings and Mortgage Company.

In 2011-2012, League Savings and Mortgage Company worked with a group of interested credit unions to build a regional approach to the mortgage market. While ultimately the group could not agree to a consistent approach on a regional level, the work done has been leveraged by smaller groups of credit unions. An early success with a group of PEI credit unions has led to the development of a regional campaign scheduled for 2013 which may be an important step towards our ultimate goal of achieving a sustained, regional approach to the mortgage market.

League Savings and Mortgage Company continues to seek new opportunities for partnership with other organizations. In 2012, our strategic alliance with Concentra Financial was reviewed and updated, and discussions continued with other national system partners for the benefit of the Atlantic credit union system. Closer to home, our continued collaboration with Atlantic Central and League Data Limited will allow for greater alignment of priorities in the future.

League Savings and Mortgage Company's annual strategic planning session was held in June, and a thorough review of our system's trends was completed and options for moving forward were discussed. The Board of Directors felt that League Savings and Mortgage Company should be seen as a leader and trusted partner in meeting the needs of credit union members in Atlantic Canada. There are significant strategic discussions taking place with the Role and Relationship Committee, and the Board of Directors agreed that League Savings and Mortgage Company would align itself with Atlantic Central and the recommendations and direction from the Role and Relationship Committee's Final Report. The Board of Directors reaffirmed that decision with the release of the Report in October and is pleased to see the emphasis on the Report's recommendations in our 2013 plans.

Looking ahead, a key objective from the Board of Director's perspective is for League Savings and Mortgage Company to continue its integration with Atlantic Central. Through this, the opportunity to leverage the skills and experience in both companies will prove to be most

beneficial to the credit union system. There is a strong role for League Savings and Mortgage Company in the Atlantic credit union system which was outlined in the Role and Relationship Report.

League Savings and Mortgage Company brings value through its deposit, credit and commercial expertise, its competitive pricing, its collaborative work with other system partners as well as through our relationship management efforts with credit unions. These, combined with a genuine desire to assist credit unions in being successful, is what positions League Savings and Mortgage Company as a unifying force in the credit union system.

On behalf of the Board of Directors I would like to thank the management and staff of League Savings and Mortgage Company for their dedication to the success of credit unions in Atlantic Canada, and indeed, the entire co-operative system. As we look to the future, hard work and collaboration by all will result in a more unified and successful credit union system.

Jim MacFarlane
*Chair of the Board*

# Message from the President & Chief Executive Officer

League Savings and Mortgage Company continues to build on its relationship with credit unions in the Atlantic region. Our system is strengthened when credit unions avail themselves of the extended resources of League Savings and Mortgage Company in order to meet their objectives and satisfy member needs that they may not otherwise be able to accomplish. Thanks to these partnerships League Savings and Mortgage Company enjoyed a very good year from a financial perspective. We operate in a very challenging economic environment where financial institutions are vying for new business and the competition is only expected to increase. Increased emphasis is being placed on managing the operating costs of our company and ensuring service to credit unions is not negatively impacted.

We were able to make a special distribution to credit unions of $500,000 over and above the mortgage and deposit referral fees based on market, as well as distributions of earnings in the form of portfolio fees to credit unions. We also paid a 3% dividend on share capital and a bonus payment of 1.5% on subordinated debentures, bringing the return on subordinated debentures to 4.5%. Additionally, the liquidity rebate paid by Atlantic Central includes deposits held at League Savings and Mortgage Company which contributes to additional returns on funds invested with League Savings and Mortgage Company. I believe these results and achievements speak highly of our dedicated management and employees who place a high priority on providing excellent service to our credit unions.

***Economic Environment***

The economic environment continues to be challenging, and the low interest rate environment mentioned in the last number of years continues to be with us, and there is no reason to think that this will change in the immediate future. This puts considerable pressure on Atlantic Central, League Savings and Mortgage Company and the credit unions in the Atlantic region and will impact our future operations as we strive to be competitive in the marketplace.

The world economy continues to be fragile and there are fears of recession in various parts of the world including the United States. Should the United States go into a recession, then Canada would not be far behind. In fact, the economic indicators in Canada have not achieved the levels that have been forecast for the past year or so and this is contributing to the low interest rate environment. The federal government has taken steps to curb the growth of personal debt in our country, which is at an all time high, as well as taking steps to cool the mortgage market which is becoming increasingly competitive.

***Our People***

As you are aware, Atlantic Central completed its first two years of operation, and the operation of League Savings and Mortgage Company is very much entwined in the operation of Atlantic Central. The two companies portray a single image to credit unions and have the same objectives in providing service to credit unions and credit union members in Atlantic Canada. I am pleased with the manner in which our employees have adjusted to change and uncertainty, and the economic environment continues to have an impact on our employee group and contributes to the uncertainty in the marketplace.

***Satisfaction Survey***

Our Satisfaction Surveys for 2012 were excellent, as they have been for the last number of years. I believe this is a significant accomplishment considering the ever changing environment and challenges facing the credit union system. It is obvious that credit unions appreciate the services provided and this rating can only be achieved through the excellence of our people and their commitment and professionalism in dealing with you, the credit unions.

***Role and Relationship Committee***

League Savings and Mortgage Company's Board of Directors and management played an integral role in the development of the Role and Relationship Committee Report. The Chair of the Board, Jim MacFarlane, was part of this Committee, along with senior management. The Board of Directors of League Savings and Mortgage Company fully endorsed the Role and Relationship Committee Report, and although Atlantic Central will take the lead role in the implementation of the recommendations, League Savings and Mortgage Company will be playing an integral role in the advancement of the credit union system in Atlantic Canada. These recommendations will also impact the operation and structure of League Savings and Mortgage Company on a go forward basis.

***Conclusion***

I wish to thank the Board of Directors of League Savings and Mortgage Company for their support, guidance, and commitment to the credit union system and for acting in the best interests of the entire credit union system. I would also like to acknowledge the contribution of the Executive Management Team, who put many extra hours into having League Savings and Mortgage Company be meaningful and responsive to the needs of our credit unions. They exhibit true professionalism, commitment, and a strong desire for our system to succeed. To our employees for continuing to offer dedicated, enthusiastic, and knowledgeable support to our credit unions, I also say thank you.

On a personal note, I wish to thank the Board of Directors, as well as Executive Management, and all employees of League Savings and Mortgage Company whom I have had the pleasure and honour to lead for the past 10 years. I also want to acknowledge the support I have received from credit unions in Atlantic Canada and the various representatives of the credit unions. I felt that you acted in what you considered to be the best interests of your members and potential members. I will always look back on my time as an employee and participant in this system as a most rewarding experience, and I wish you every success in dealing with the challenges and opportunities available to this system. I believe the only constraint on our success in changing and being sustainable, relevant, and competitive is indeed our desire to achieve.

I wish Michael Leonard every success in his leadership role as President & Chief Executive Officer of League Savings and Mortgage Company, and I look forward to significant change under his leadership.

Respectively submitted,

Bernie O'Neil
*President & Chief Executive Officer*

Back Row (L-R): Victoria Mainprize, Paul Paruch, Michael Leonard, Sharon Arnold
Front Row (L-R): Kim Walker, Bernie O'Neil

## Risk Management

Risk management is one of the most important responsibilities of League Savings and Mortgage Company. Risk management objectives are reflected within the comprehensive risk management strategies and policies.

League Savings and Mortgage Company's risk management strategies and policies are governed by the principle of optimizing risk for the protection and creation of shareholder value, and are designed to ensure that the company's risk-taking is consistent with its business objectives and risk tolerance.

League Savings and Mortgage Company uses an enterprise-wide approach to identify, measure, monitor and manage organizational risk. Authority for all risk-taking activities rests with the Board of Directors, which approves risk management policies, delegates limits and regularly reviews management's risk assessments and compliance with approved policies. The Risk Committee of the Board of Directors is responsible for ensuring that management has developed and maintained an effective Enterprise Risk Management Framework for evaluating the business strategies being used for allocation of human, capital and other resources. The Audit Committee is responsible for overseeing all financial risk management policies.

The Management Finance Committee (MFC) is responsible for the review and evaluation of financial risks and performance. The MFC reviews financial risk management policies, recommends changes to policies and procedures as appropriate, and monitors compliance with financial policies. The Asset Liability Management Committee (ALCO) is responsible for ensuring the effective and prudent management of League Savings and Mortgage Company's financial assets and liabilities. ALCO achieves this by developing and implementing financial strategies and related processes consistent with the short and long-term goals set by the Board of Directors.

Qualified professionals throughout  the company manage these risks through comprehensive and integrated control processes and models, including regular review and assessment of risk measurement and reporting processes. The various processes within League Savings and Mortgage Company's risk management framework are designed to ensure that risks in the various business activities are properly identified, measured, assessed and controlled. Internal Audit reports independently to the Audit Committee of the Board of Directors on the effectiveness of the risk management policies and the extent to which internal controls are in place and operating effectively.

The risks are summarized into the following categories: capital adequacy, governance, credit, legal and regulatory, liquidity, market, operational and strategic.

## Capital Adequacy Risk

Capital adequacy risk is the risk of financial loss or regulatory intervention due to the failure of League Savings and Mortgage Company to raise the necessary capital to support its business plans.

League Savings and Mortgage Company has established capital management policies, which govern the quantity and quality of capital that the company will maintain. An Internal Capital Adequacy Assessment Process (ICAAP), has been implemented which establishes capital targets and strategies for achieving those targets based on the company's business plans and risk assessment which incorporates stress testing. A capital plan is prepared annually which forecasts the amount of capital required throughout the year and the sources that will be used to fund those requirements. The capital policies and plans are reviewed and approved annually by the Board of Directors. Current capital plans incorporate OSFI's "Basel III" requirements.

Management regularly monitors the company's capital position and reports to the Board of Directors on a quarterly basis.

## Governance Risk

Governance risk is the risk of financial and/or reputational loss caused by a lack of effectiveness of the Board of Directors and senior management.

Governance risk is mitigated through the nomination and election process, orientation program, ongoing development and training, regular Board  of Directors and committee meetings, the annual strategic planning process and an annual evaluation process.

## Credit Risk

Credit risk is the potential for loss due to the failure of a borrower, endorser or guarantor to fulfill its payment obligation.

League Savings and Mortgage Company has established policies and procedures for credit risk management. Credit policies are reviewed and approved annually by the Board of Directors. Management regularly reviews its credit procedures to ensure they provide extensive, up-to-date guidance for the underwriting and administration of all types of loans.

All loans are risk rated at the time of approval, and may be subject to subsequent risk assessment based on factors such as loan type, amount, original risk rating and payment history. In addition to considering loan type and amount in setting approval limits, loans with higher risk require more intensive analysis and higher levels of approval.  The Credit Committee of the Board of Directors reviews all loans above the lending limits of management.

Procedures are in place governing credit activities including:

- Application of stringent underwriting criteria;
- The use of qualified personnel and the clear delegation of decision-making authority;
- Portfolio diversification to mitigate credit exposure by establishing concentration limits.

League Savings and Mortgage Company maintains both specific and collective allowances for credit losses. Specific allowances are established based on management's knowledge of the property and prevailing conditions. Collective allowances are maintained to cover any impairment in the loan portfolio that cannot yet be associated with specific loans. The collective allowance is determined based on League Savings and Mortgage Company's risk weighted portfolio and other factors including an assessment of market risk.

Management regularly monitors League Savings and Mortgage Company's credit risk and reports to the Board of Directors on a quarterly basis.

## Legal and Regulatory Risk

Legal and regulatory risk is the risk of loss due to failure to adhere to the legal and regulatory standards.

League Savings and Mortgage Company is governed by the *Trust and Loan Companies Act* (Canada) and regulated by the Office of the Superintendent of Financial Institutions (OSFI). League Savings and Mortgage Company also complies with provincial legislation where applicable to its operation. OSFI regularly reviews the activities of the company and periodically carries out on-site examinations. All correspondence to and from OSFI is reported to the Board of Directors by management. The company is also a member of the Canada Deposit Insurance Corporation.

League Savings and Mortgage Company maintains a legislative compliance management system in which all existing and emerging legislative and regulatory issues are reviewed and reported on. New policies and procedures are developed to address legislative requirements as appropriate.

The Board of Directors receives a quarterly compliance report in which any deficiencies and corresponding action plans are identified.

## Liquidity Risk

Liquidity risk is the risk of being unable to meet financial commitments without having to raise funds at unreasonable prices or sell assets on a forced basis.

League Savings and Mortgage Company has established policies to ensure it is able to generate sufficient funds to meet all of its financial commitments in a timely and cost-effective manner. In addition, a liquidity plan is prepared which forecasts the amount of liquidity required and the sources that will be used to fund those requirements. These policies and plans are annually reviewed and approved by the Board of Directors.

League Savings and Mortgage Company's liquidity management practices include:

- Ensuring the quality of investments acquired for liquidity purposes meet very high standards;
- Matching the maturities of assets and liabilities;
- Diversifying funding sources;
- Establishing and maintaining minimum liquidity reserves;
- Monitoring actual cash flows on a daily basis;
- Forecasting future cash flow requirements;
- Utilizing lines of credit to fund temporary needs and selling or securitizing mortgage pools to meet longer term requirements;
- Stress testing and contingency planning.

Management monitors the company's liquidity position daily and reports to the Board on a quarterly basis.

## Market Risk

Market risk is the risk of loss that results from changes in interest rates, foreign exchange rates, equity prices and commodity prices.

Market risk exposures are managed through policies, standards and limits established by the Board of Directors, which are formally reviewed and approved annually. League Savings and Mortgage Company uses a variety of techniques to identify, measure and control market risk. Derivatives may be used only to offset clearly

identified risks. League Savings and Mortgage Company has developed standards regarding the use of derivative products.

Interest rate risk is the risk that a movement in interest rates will have on the financial condition of the company. League Savings and Mortgage Company's interest rate risk policies include limits on the allowable variation in forecasted financial margins due to interest rate changes. League Savings and Mortgage Company manages and controls interest rate risk primarily by managing asset/ liability maturities; however, off-balance sheet techniques such as interest rate risk contracts may be used to hedge against specific interest rate risk exposures.

League Savings and Mortgage Company measures interest rate risk through gap and income simulation analysis on a quarterly basis. Gap analysis measures the difference between the amount of assets and liabilities repricing in specific time periods. Income simulation models are used to measure interest rate risk exposure under various assumptions about interest rates, products, volumes and pricing.

Sensitivity analysis of an interest rate increase and decrease of 100 basis points is illustrated in the table below.

Earnings at risk over the next 12 months as at December 31:

| (Dollars) | 2012 | 2011 |
|---|---|---|
| 100 basis point increase | (269,400) | (364,000) |
| 100 basis point decrease | 139,900 | 337,000 |

Management provides quarterly reports to the Board of Directors on interest rate risk.

Foreign exchange risk is the risk of loss caused by fluctuations in foreign exchange rates. League Savings and Mortgage Company is not exposed to foreign exchange risk as Board policy requires that all transactions be carried out in Canadian currency.

Equity and commodity risk is the potential impact on League Savings and Mortgage Company's earnings due to movements in equity and commodity prices. League Savings and Mortgage Company has no material business activities in equities or commodities, and is not exposed to material risk in these areas.

## Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed processes, technology or human performance, or from external events.

While operational risk can never be fully eliminated, League Savings and Mortgage Company manages this type of risk through implementation of a comprehensive set of procedures and policies. Elements include:

- Developing and maintaining a comprehensive system of internal controls, encompassing segregation of functional activities, managerial reporting and delegation of authority;
- Striving to maintain industry best practices in the area of operational risk management through continued monitoring and evaluation of our practices;
- Selection and training of highly qualified staff, supported by policies that provide for skills upgrading, clear authorization levels and adherence to an employee code of conduct;
- Maintaining adequate insurance to reduce the impact of any potential losses, supported by a detailed business continuity plan.

## Strategic Risk

Strategic risk is the risk of loss due to a failure to create, implement and monitor an effective strategic plan, including procedures for the development and review of new business initiatives and changing business circumstances.

Strategic priorities for the next 12-18 months are established during the annual Board and Management Planning Session. Management then develops the annual business plan for approval by the Board. Management reports to the Board of Directors on the progress towards achieving the annual business plan at each regular Board of Directors meeting.

# LEAGUE SAVINGS AND MORTGAGE COMPANY

# FINANCIAL STATEMENTS

DECEMBER 31, 2012

## Management's Responsibility For Financial Statements

Management has the responsibility of preparing the accompanying financial statements and ensuring that all information in the annual report is consistent with the financial statements. This responsibility includes selecting appropriate accounting principles and making objective judgments and estimates in accordance with International Financial Reporting Standards.

In discharging its responsibility for the integrity and fairness of the financial statement, management designs and maintains the necessary accounting systems and related internal controls to provide reasonable assurance that transactions are authorized, assets safeguarded and proper records maintained. The Board of Directors has appointed an Audit Committee to review the annual financial statements with management and auditors before final approval by the Board.

The federal regulator of financial institutions conducts examinations and makes such enquiries into the affairs of League Savings and Mortgage Company (League Savings) as they deem necessary to ensure the safety of depositors and to ensure that the Company is in sound financial condition. Their findings are reported directly to management.

Grant Thornton LLP, the independent auditors, have examined the financial statements of League Savings in accordance with Canadian generally accepted auditing standards and have expressed their opinion in the following report to shareholders.

**Bernie O'Neil**

President and CEO

**Sharon Arnold, CA**

Senior Vice-President Finance

## Independent Auditors' Report

**To the Shareholders of League Savings and Mortgage Company**

We have audited the accompanying financial statements of League Savings and Mortgage Company ("League Savings"), which comprise the balance sheet as at December 31, 2012, the statements of comprehensive income, changes in shareholders' equity, and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

### Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to League Savings' preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of League Savings' internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of League Savings and Mortgage Company Limited as at December 31, 2012, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

**Grant Thornton LLP** **February 18, 2013**

**Chartered Accountants** **Halifax, Canada**

**Balance Sheet**

| **December 31** (Cdn Dollars) | Note | **2012** | 2011 |
|---|---|---|---|
| **Assets** | | | |
| Cash and cash equivalents | | **$ 69,708** | $ 22,744 |
| Investments | 5 | **28,032,634** | 26,557,131 |
| Loans and mortgages | 6 | **418,696,403** | 427,908,912 |
| Accrued interest | | **1,231,075** | 1,320,396 |
| Income tax receivable | | **554,162** | - |
| Deferred tax asset | 12 | **498,954** | 534,728 |
| Other assets | | **1,234,149** | 3,566,173 |
| | | **$ 450,317,085** | $ 459,910,084 |
| **Liabilities** | | | |
| Borrowings | 14 | **$ 4,919,583** | $ 13,578,441 |
| Deposits | 15 | **393,170,044** | 398,632,390 |
| Accrued interest | | **4,123,668** | 4,386,366 |
| Accounts payable and accrued | | **2,907,197** | 4,056,517 |
| Income tax payable | | **-** | 529,461 |
| Mortgage backed securities | 19 | **5,460,960** | - |
| Subordinated debentures | 17 | **7,102,000** | 7,102,000 |
| | | **417,683,452** | 428,285,175 |
| **Shareholders' equity** | | | |
| Capital stock | 8 | **16,096,797** | 15,996,797 |
| Contributed surplus | | **1,785,887** | 1,785,887 |
| Retained earnings | | **14,329,880** | 13,145,404 |
| Accumulated other comprehensive income | | **421,069** | 696,821 |
| | | **32,633,633** | 31,624,909 |
| | | **$ 450,317,085** | $ 459,910,084 |
| Commitments and contractual obligations | 11 | | |

**Approved:** **On Behalf of the Board:**

Bernie O'Neil
President and CEO

Jim MacFarlane
Chair

Doug Dewling
Director

See accompanying notes to the financial statements

## Statement of Comprehensive Income

| Year Ended December 31<br>(Cdn Dollars) | Note | 2012 | 2011 |
|---|---|---|---|
| **Financial income** | | | |
| Interest on investments | | **$ 946,912** | $ 1,012,093 |
| Interest on loans and mortgages | | **20,822,557** | 23,063,760 |
| | | **21,769,469** | 24,075,853 |
| **Financial expense** | | **9,967,591** | 11,318,978 |
| Gross financial margin | | **11,801,878** | 12,756,875 |
| Provision for loan losses (recovery) | | **(332,476)** | (80,979) |
| Net financial margin | | **12,134,354** | 12,837,854 |
| Other financial income | | **621,120** | 729,262 |
| Net financial income | | **12,755,474** | 13,567,116 |
| Non-interest income (expense) | 18 | **(304,913)** | 640,975 |
| | | **12,450,561** | 14,208,091 |
| **Operating expenses** | | | |
| Salaries and staff related | | **2,952,986** | 3,404,547 |
| Employee benefits | | **496,689** | 503,808 |
| Management fees | | **2,739,000** | 2,220,000 |
| Office expense | | **811,190** | 850,206 |
| Marketing and business development | | **53,298** | 64,186 |
| Democracy | | **169,484** | 139,980 |
| Professional fees | | **145,423** | 140,796 |
| Other expenses | | **229,131** | 266,131 |
| | | **7,597,201** | 7,589,654 |
| Operating income | | **4,853,360** | 6,618,437 |
| Interest on subordinated debentures | | **319,590** | 426,120 |
| Distributions | | **1,915,920** | 2,329,156 |
| Income before taxes | | **2,617,850** | 3,863,161 |
| Taxes | 12 | **998,772** | 1,392,855 |
| **Net income** | | **$ 1,619,078** | $ 2,470,306 |
| **Other comprehensive income (OCI)** | | | |
| Net change in unrealized gains (losses) on available for sale investments | | **(392,302)** | (185,124) |
| Income taxes relating to OCI | 12 | **116,550** | 58,208 |
| Other comprehensive loss | | **(275,752)** | (126,916) |
| **Comprehensive income** | | **$ 1,343,326** | $ 2,343,390 |

See accompanying notes to the financial statements

## Statement of Changes in Shareholders' Equity

| **Year Ended December 31, 2012**<br>(Cdn Dollars) | **Common Shares** | **Preferred Shares** | **Contributed Surplus** | **Accumulated Other Comprehensive Income** | **Retained Earnings** | **Total Equity** |
|---|---|---|---|---|---|---|
| **Balance at beginning of year** | **$ 500,000** | **$ 15,496,797** | **$ 1,785,887** | **$ 696,821** | **$ 13,145,404** | **$ 31,624,909** |
| Net income | | | | | 1,619,078 | **1,619,078** |
| Other comprehensive loss | | | | (275,752) | | **(275,752)** |
| Comprehensive income | - | - | - | (275,752) | 1,619,078 | **1,343,326** |
| Shares issued (Note 8) | 1,610,057 | | | | | **1,610,057** |
| Shares redeemed (Note 8) | | (1,510,057) | | | | **(1,510,057)** |
| Dividends | | | | | (434,602) | **(434,602)** |
| **Balance at end of year** | **$ 2,110,057** | **$ 13,986,740** | **$ 1,785,887** | **$ 421,069** | **$ 14,329,880** | **$ 32,633,633** |

| **Year Ended December 31, 2011**<br>(Cdn Dollars) | **Common Shares** | **Preferred Shares** | **Contributed Surplus** | **Accumulated Other Comprehensive Income** | **Retained Earnings** | **Total Equity** |
|---|---|---|---|---|---|---|
| Balance at beginning of year | $ 500,000 | $ 15,496,797 | $ 1,785,887 | $ 823,737 | $ 11,109,700 | $ 29,716,121 |
| Net income | | | | | 2,470,306 | 2,470,306 |
| Other comprehensive loss | | | | (126,916) | | (126,916) |
| Comprehensive income | - | - | - | (126,916) | 2,470,306 | 2,343,390 |
| Shares issued | | | | | | - |
| Shares redeemed | | | | | | - |
| Dividends | | | | | (434,602) | (434,602) |
| Balance at end of year | $ 500,000 | $ 15,496,797 | $ 1,785,887 | $ 696,821 | $ 13,145,404 | $ 31,624,909 |

See accompanying notes to the financial statements

## Statement of Cash Flows

| **Year Ended December 31**<br>(Cdn Dollars) | **2012** | **2011** |
|---|---|---|
| Increase (decrease) in cash and cash equivalents | | |
| **Operating activities** | | |
| Income before taxes | **$ 2,617,850** | $ 3,863,161 |
| Adjustments: | | |
| Loans and mortgages, net | **9,212,509** | 24,076,382 |
| Deposits, net | **(5,462,346)** | (27,536,719) |
| Mortgage backed security, net | **5,460,960** | - |
| Depreciation | **-** | 36,992 |
| Interest receivable/payable, net | **(173,377)** | 111,767 |
| Taxes paid, net of refunds | **(1,462,821)** | (634,256) |
| Other items, net | **323,152** | (5,453,647) |
| | **10,515,927** | (5,536,320) |
| **Financing activities** | | |
| Common shares issued | **100,000** | - |
| Dividends paid | **(434,602)** | (434,602) |
| | **(334,602)** | (434,602) |
| **Investing activities** | | |
| Investments, net | **(1,475,503)** | 583,384 |
| Fixed assets, net | **-** | 37,881 |
| | **(1,475,503)** | 621,265 |
| **Net increase (decrease) in cash and cash equivalents** | **8,705,822** | (5,349,657) |
| **Cash and cash equivalents (net)** | | |
| Beginning of year | **(13,555,697)** | (8,206,040) |
| End of year | **$ (4,849,875)** | $ (13,555,697) |
| Includes: | | |
| Cash on hand and balances with Central | **$ 69,708** | $ 22,744 |
| Borrowings | **(4,919,583)** | (13,578,441) |
| | **$ (4,849,875)** | $ (13,555,697) |
| **Supplemental disclosure of cash flow information:** | | |
| Interest received | **$ 21,851,703** | $ 24,683,531 |
| Dividends received | **7,087** | 7,055 |
| Interest paid | **10,230,289** | 12,248,064 |

See accompanying notes to the financial statements

## 1. Reporting entity

League Savings and Mortgage Company ("the Company") is incorporated in Canada under the Federal Trust and Loan Companies Act. The Company is a member of Canada Deposit Insurance Corporation, and is regulated by the Office of the Superintendent of Financial Institutions (OSFI). Its head office is located at 6074 Lady Hammond Road in Halifax, Nova Scotia, and the Company also operates out of offices in Sydney, Nova Scotia, Riverview, New Brunswick and Charlottetown, Prince Edward Island. The Company provides financial services to credit unions, their members, and others.

Atlantic Central owns 100% of the common shares. Preferred A shares are primarily owned by credit unions in the Atlantic Provinces. Atlantic Central is the continuance of Credit Union Central of Nova Scotia and is owned by credit unions in the Atlantic Provinces.

## 2. Basis of presentation

The financial statements are presented in Canadian dollars and have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). The principal accounting policies applied in the preparation of the financial statements are set out in Note 3. The financial statements have been prepared on the historical cost basis except for certain financial instruments as indicated in Note 3.

In preparing the Company's financial statements, management is required to make estimates, judgments and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenue and expenses during the period. Actual results could differ from those estimates. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recorded in the period in which the estimate reversed if the revision affects only that period or in the period of revision and in future periods if the revision affects both the current and future periods.

The judgments that have the most significant effect on the amounts recognized in the financial statements are with respect to the allowance for loan losses, as detailed in Note 3.

The financial statements were authorized for issue by the Board of Directors on February 18, 2013.

## 3. Summary of significant accounting policies

### Financial instruments

Financial assets and liabilities are initially recognized at fair value and are subsequently accounted for based on their classification as described below.

Financial assets must be classified as fair value through profit or loss (FVTPL), available for sale (AFS), held-to-maturity (HTM) or loans and receivables (L&R). Financial liabilities are required to be classified as FVTPL or

other financial liabilities (OFL). All financial instruments, including all derivatives, are measured at fair value on the balance sheet with the exception of loans and receivables, held-to-maturity investments and other financial liabilities which are measured at amortized cost.

A financial asset is derecognized when the contractual rights to the cash flows from the asset have expired, or the Company transfers the contractual rights to receive the cash flows from the asset, or has assumed an obligation to pay those cash flows to a third party and the Company has transferred substantially all of the risks and rewards of ownership of that asset to a third party. A financial liability is derecognized when the obligation under the liability is discharged or cancelled or expires.

Changes in fair values of financial assets and financial liabilities classified as FVTPL are reported in earnings, while the changes in value of available for sale financial assets are reported within Other Comprehensive Income (OCI) until the financial asset is disposed of, or becomes impaired.

Accumulated OCI is reported on the balance sheet as a separate component of Shareholders' Equity. It includes, on a net of taxes basis, the net unrealized gains and losses on available for sale financial assets.

The Company has classified its financial instruments as follows:

| | |
|---|---|
| FVTPL | Cash and cash equivalents, interest rate swaps |
| AFS | Investments |
| L&R | Loans and mortgages and accrued interest |
| OFL | Borrowings, deposits, mortgage backed securities (MBS), accrued interest, accounts payable and accrued and subordinated debentures |

**Cash and cash equivalents**

Cash and cash equivalents include cash on hand, and balances with Financial Institutions.

**Investments**

Investments have been designated as available for sale. Investments are initially recorded at cost with premiums and discounts amortized to maturity. Except as noted below, investments are reported at market value with any unrealized gains or losses reported in OCI.

Certain investments in co-operative partners are reported at cost, as fair value cannot be reliably measured.

Investment income is recognized on an accrual basis. Realized gains and losses on the disposal of securities are included in investment income. All securities are held for investment purposes.

**Loans and mortgages**

Loans and mortgages have been designated as loans and receivables. Loans and mortgages are net of allowances established to recognize anticipated losses. The amount provided for anticipated loan losses is determined by reference to specific loans or mortgages in arrears and by the judgment of management.

Loans are assessed for impairment either individually, where appropriate, or collectively. A collective allowance has been established to provide for losses on loans and mortgages where past experience and existing economic and portfolio conditions indicate that losses have occurred, but where such losses cannot be specifically identified on an account-by-account basis.

Specific allowances are provided for individual loans that have experienced deterioration in credit quality such that there is no longer a reasonable assurance of the timely collection of the full amount of principal and interest, and where the current carrying value of the loan is greater than the present value of the future cash flows. The assessment of individual loans includes monthly reporting on delinquent accounts as well as an evaluation of other accounts where the possibility of loss exists, and includes an assessment of the security on the loan.

The collective allowance is determined based on management's judgment considering business and economic conditions, portfolio composition, historical credit performance and other relevant factors. Pools of loans are assessed based on attributes specific to a defined group of borrowers, and considers other characteristics that directly affect the collectability of loans that are unique to the defined group of borrowers (such as inherent credit risk, industry, and geography). Each pool of loans is assigned a portfolio risk factor, which is used to determine a base amount required for the collective allowance. This base amount is adjusted to reflect the fluctuations in market conditions that most highly correlate with credit losses.

Real estate held for resale is carried at the market value of the property acquired, based on estimates of the revenues to be received and costs to be incurred subsequent to foreclosure, and the estimated net proceeds from the sale of the property.

The Company periodically sells or purchases mortgages, primarily to or from credit unions. In these transactions, the seller continues to administer the loans sold, but the contractual right to receive payments on the loans is offset by an obligation to transfer these payments to the purchaser. The loans sold by the Company are derecognized, and the loans purchased are recognized, on the date of the transfer.

**Mortgage backed securities**

The Company securitizes insured residential mortgages through the creation of mortgage backed securities (MBS) under the National Housing Act Mortgage-Backed Securities (NHA MBS) program sponsored by Canada Mortgage and Housing Corporation (CMHC). The MBS created under the program are sold to third-party investors.

Under the NHA MBS program, the Company continues to administer the loans securitized, and is entitled to the payments received on the mortgage. At the same time, the Company is obligated to make the payments due on the issued MBS, including the investment yield due to the investors in the security, regardless of whether the Company has collected the funds from the mortgagor.

The sale of mortgages through the NHA MBS program do not meet the requirements for derecognition. The Company has not transferred substantially all the risks and rewards of ownership of the underlying mortgages, as the Company retains the prepayment, credit and interest rate risk associated with the mortgages. As a

result, the Company continues to recognize the underlying mortgages in assets as secured loans and the cash proceeds from the securitization are recognized as liabilities.

**Fixed assets**

Fixed assets are carried at cost less accumulated depreciation. Depreciation is calculated using the straight-line method over the estimated useful lives of the related assets. The useful life and residual value of fixed assets are reviewed at least annually. Depreciation rates are as follows:

| | |
|---|---|
| Leasehold improvements | 2-10% |
| Furniture and equipment | 20-33% |

**Impairment**

Investments are reviewed for impairment on at least an annual basis. Changes in the fair value of available for sale investments are reported in Other Comprehensive Income. If the investment is impaired, however, any cumulative losses previously recognized in OCI are reclassified from equity to net income.

Loans and mortgages are classified as impaired at the earlier of when, in the opinion of management, there is reasonable doubt as to the collectability of principal or interest, or when interest or principal is contractually past due 90 days, unless the loan or mortgage is both well secured and in the process of collection. Interest on an impaired loan or mortgage continues to be recognized in earnings on an accrual basis and is provided for in the allowance for loan losses.

Non-financial assets are assessed for impairment at least annually and, where impairment exists, the carrying value is reduced to the recoverable amount, and any adjustment is recognized in earnings.

**Revenue and expense recognition**

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Company and the revenue can readily be measured. The principal sources of revenue are interest and fee income. Operating expenses are recognized upon the utilization of the services or at the date of their origin.

Interest on loans and mortgages is recognized and reported on an accrual basis using the effective interest method. Expenses incurred directly in the origination of loans and mortgages are deferred and recognized in the income statement, as a reduction to income over the expected life of the relevant loans and mortgages.

The Company periodically sells mortgages. Gains or losses are recognized on transfers of mortgages to other parties when the Company has transferred the significant risks and rewards of ownership. Where the Company continues to service the mortgages, an administration fee is calculated on the outstanding balance of the mortgages. This fee is recognized as the services are provided and reported in earnings as other income.

## Leases

A lease transfers the economic ownership of a leased asset if the lessee bears substantially all the risks and rewards related to the ownership of the leased asset. The related asset is then recognized at the inception of the lease at the fair value of the leased asset or, if lower, the present value of the lease payments plus incidental payments, if any. A corresponding amount is recognized as a finance leasing liability.

All other leases are treated as operating leases. Payments on operating lease agreements are recognized as an expense on a straight-line basis over the lease term. Associated costs, such as maintenance and insurance, are expensed as incurred.

## Income taxes

Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognized in net income except to the extent that it relates to a business combination, or items recognized directly in equity or in other comprehensive income.

Current income taxes are recognized for the estimated income taxes payable or receivable on taxable income or loss for the current year and any adjustment to income taxes payable in respect of previous years. Current income taxes are measured at the amount expected to be recovered from or paid to the taxation authorities. This amount is determined using tax rates and tax laws that have been enacted or substantively enacted by the year-end date.

Deferred tax assets and liabilities are recognized where the carrying amount of an asset or liability differs from its tax base, except for taxable temporary differences arising on the initial recognition of goodwill and temporary differences arising on the initial recognition of an asset or liability in a transaction which is not a business combination and at the time of the transaction affects neither accounting or taxable profit or loss.

Recognition of deferred tax assets for unused tax (losses), tax credits and deductible temporary differences is restricted to those instances where it is probable that future taxable profit will be available which allow the deferred tax asset to be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

The amount of the deferred tax asset or liability is measured at the amount expected to be recovered from or paid to the taxation authorities. This amount is determined using tax rates and tax laws that have been enacted or substantively enacted by the year-end date and are expected to apply when the liabilities / (assets) are settled / (recovered).

## Deposits

Deposits are measured at fair value on recognition net of transaction costs directly attributable to issuance. Subsequent measurement is at amortized cost using the effective interest method.

## Employee benefits

Short-term employee benefits include salaries and wages, compensated absences, medical and dental plans, and variable compensation. The Company also contributes on behalf of employees to a Group Savings for Retirement Program and to life and long-term disability insurance plans. Under these defined contribution programs the Company pays fixed contributions to an independent entity and has no legal or constructive

obligation to pay further contributions. These costs are expensed as the related service is provided, and are reported in income as employee benefits.

**Changes in accounting standards**

A number of new standards, and amendments to standards and interpretations, are not yet effective for the year ended December 31, 2012 and have not yet been adopted by the Company in preparing these financial statements. Other than the introduction of IFRS 9, these changes are not expected to have a material impact on the financial statements.

*IFRS 9 Financial Instruments*

In November 2009, the IASB issued *IFRS 9 – Financial Instruments*, introducing new requirements for classifying and measuring financial assets. This new standard replaces the requirements in *IAS 39 – Financial Instruments: Recognition and Measurement* for classification and measurement of financial assets. IFRS 9 is the first part of a multi-phase project to replace IAS 39. The main features of the new standard are:

- A financial asset will be classified as either fair value or amortized cost. The available-for-sale, held-to-maturity, and loans and receivables categories will no longer exist.
- Classification of financial assets is based on the entity's business model for managing the financial asset and their contractual cash flow characteristics.
- Changes in the fair value of financial assets classified as fair value are recognized in profit or loss, except for equity investments not held for trading, which may be held at fair value through other comprehensive income.

In 2012 the effective date for the mandatory implementation of IFRS 9 was deferred to fiscal years beginning on or after January 1, 2015. Earlier application is permitted. The impact of IFRS 9 on the Company has not yet been determined.

Other standards and amendments have been issued but are not yet effective and are not expected to have a material impact. They include:

| Standard | Effective Date (periods beginning on or after) |
| --- | --- |
| *IFRS 7 – Financial Instruments: Disclosures* – provides common disclosure requirements for offsetting arrangements. | January 1, 2013 |
| *IFRS 10 – Consolidated Financial Statements* – defines the principle of control as the basis for determining which entities should be consolidated. | January 1, 2013 |
| *IFRS 11 – Joint Arrangements* – deals with entities that have interests in arrangements that are jointly controlled. | January 1, 2013 |

| Standard | Effective Date (periods beginning on or after) |
| --- | --- |
| *IFRS 12 – Disclosure of Interests in Other Entities* – provides enhanced disclosures about an entity's interest in subsidiaries, joint arrangements, associates and unconsolidated structured entities. | January 1, 2013 |
| *IFRS 13 – Fair Value Measurement* – sets out a single standard framework for fair value measures when other IFRS's require or permit them. | January 1, 2013 |
| *IAS 19 – Employee benefits* – deals with defined benefit plans. | January 1, 2013 |
| *IAS 27 – Separate Financial Statements* and *IAS 28 – Investments in Associates and Joint Ventures* – are amended to conform with changes in IFRS 10, IFRS 11 and IFRS 12. | January 1, 2013 |
| *IAS 32 – Financial Instruments: Presentation* – which clarifies requirements for offsetting financial assets and financial liabilities. | January 1, 2014 |

## 4. Risk management

The Company has an enterprise-wide approach to the identification, measurement, monitoring and management of risks faced across the organization. The Company manages significant risks efficiently and effectively through an Enterprise Risk Management Process (ERM) which includes a comprehensive infrastructure of policies, procedures, methods, oversight and independent review, designed to reduce the significant risks and to manage those risks within appropriate tolerances for the Company.

Authority for all risk-taking activities rests with the Board of Directors (Board), which is responsible for setting the Company's tolerance for risk, approves risk management policies, delegates limits and regularly reviews management's risk assessments and compliance with approved policies. Qualified professionals throughout the Company manage these risks through comprehensive and integrated control processes and models, including regular review and assessment of risk measurement and reporting processes.

The various processes within the Company's risk management framework are designed to ensure that risks in the various business activities are properly identified, measured, stress tested, assessed and controlled. Internal Audit reports independently to the Audit, Risk & Conduct Review Committee of the Board on the effectiveness of the risk management policies and the extent to which internal controls are in place and operating effectively.

Stress testing is a risk measurement technique that examines the potential effects on the Company's financial condition resulting from adverse economic, liquidity, credit, and/or financial market conditions. The Company's risk management processes include stress testing scenarios including exceptional but plausible adverse events that can impact the Company's financial results and capital requirements, the results of which

are used to enhance our understanding of our risk profile, and to support our strategic decision making. Stress testing results are also explicitly incorporated into the Company's Internal Capital Adequacy Assessment Process (ICAAP) and Capital Plan.

The Management Finance Committee (MFC) is responsible for the review and evaluation of the financial risks and performance of the Company, including the management of:

- Credit risk
- Interest rate risk
- Investment portfolio
- Large exposures
- Liquidity
- Foreign exchange
- Derivatives
- Capital

The MFC reviews financial risk management policies, recommends changes to policies and procedures as appropriate, and monitors compliance with financial policies.

The Asset Liability Management Committee (ALCO) has been established to ensure the effective and prudent management of the Company's financial assets and liabilities. ALCO will achieve this by developing and implementing financial strategies and related processes consistent with the short and long term goals set by the Board.

**Credit risk**

Credit risk is the potential for loss due to the failure of a borrower, endorser or guarantor to fulfill its payment obligation to the Company. Credit risk arises in the Company's direct lending operations and in its funding and investing activities where counterparties have repayment or other obligations to the Company. The Company has established policies and procedures for credit risk management, including counterparty limits relating to investment activities.

Management of credit risk requires prudent and conservative underwriting criteria administered by well-trained and experienced personnel. Credit risk management practices also include consistent and timely collection procedures, conservative analysis of property appraisals, and a realistic loan allowance process to provide a regular evaluation of the loan portfolio. Credit policies are reviewed and approved annually by the Board. Management regularly reviews its credit procedures to ensure they provide extensive, up-to-date guidance for the underwriting and administration of all types of loans.

All loans are risk rated at the time of approval, and may be subject to subsequent risk assessment based on factors such as loan type, amount, original risk rating and payment history. Loans with higher risk require more intensive analysis and higher levels of approval. The Credit Committee of the Board reviews all loans above the lending limits of management.

The Company maintains both specific and collective allowances for credit losses. Specific allowances are established based on management's knowledge of the property and prevailing conditions. Collective allowances are maintained to cover any impairment in the loan portfolio that cannot yet be associated with

specific loans. The collective allowance is determined based on the Company's risk weighted portfolio and other factors including an assessment of market risk.

Management regularly monitors the Company's credit risk and reports to the Board on a quarterly basis.

**Liquidity risk**

Liquidity refers to the capacity to generate or obtain sufficient cash or its equivalent in a timely manner at a reasonable price to meet the Company's commitments as they fall due and to fund new business opportunities. Liquidity risk is the potential for losses to be incurred from holding insufficient liquidity to survive a contingent stress event.

In its role as a credit union service partner, the Company's primary financial role is to accept deposits from credit unions, their members, and others, and to employ those funds to advance loans and mortgages to credit union members and others.

The Company has established policies to ensure that it is able to generate sufficient funds to meet all of its financial commitments in a timely and cost-effective manner. In addition, a liquidity plan is prepared which forecasts the amount of liquidity required and the sources that will be used to fund those requirements. These policies and plans are annually reviewed and approved by the Board.

The Company's liquidity management practices include:

- Ensuring the quality of investments acquired for liquidity purposes meet very high standards
- Matching the maturities of assets and liabilities
- Diversifying funding sources
- Establishing and maintaining minimum liquidity reserves
- Monitoring actual cash flows on a daily basis
- Forecasting future cash flow requirements
- Utilizing lines of credit to fund temporary needs and selling or securitizing mortgage pools to meet longer term requirements
- Scenario testing and contingency planning

League Savings' cash flows are most significantly impacted by its credit union corporate deposits. As such, its scenario testing focuses on increases in the redemptions of these deposits.

Management monitors the Company's liquidity position daily and reports to the Board on a quarterly basis.

**Market risk**

Market risk is the risk of loss that results from changes in interest rates, foreign exchange rates, equity prices and commodity prices. Market risk exposures are managed through policies, standards and limits established by the Board, which are formally reviewed and approved annually.

The Company uses a variety of techniques to identify, measure and control market risk. Derivatives may be used only to offset clearly identified risks. The Company has developed standards regarding the use of derivative products.

Interest rate risk is the risk that a movement in interest rates will have on the financial condition of the Company. The Company's interest rate risk policies include limits on the allowable variation in forecasted financial margin due to interest rate changes. The Company manages and controls interest rate risk primarily by managing asset/liability maturities; however, off-balance sheet techniques such as interest rate risk contracts may be used to hedge against specific interest rate exposures.

The Company measures interest rate risk through gap and income simulation analysis on a quarterly basis. Gap analysis measures the difference between the amount of assets and liabilities repricing in specific time periods. Income simulation models are used to measure interest rate exposure under various assumptions about interest rates, products, volumes and pricing. Sensitivity analysis of an interest rate increase and decrease of 100 basis points is disclosed in the table below.

Earnings at Risk over the next 12 months as at December 31:

| | **2012** | 2011 |
|---|---|---|
| 100 basis point increase | **(269,400)** | (364,000) |
| 100 basis point decrease | **139,900** | 337,000 |

Management provides quarterly reports to the Board on interest rate risk. The Board has established limits on the Company's maximum exposure to interest rate risk, and the Company's earnings at risk were within this limit.

**5. Investments**

| | **2012 Cost** | **2012 Market Value** | 2011 Cost | 2011 Market Value |
|---|---|---|---|---|
| Government debt | **$ 2,070,220** | **$ 2,151,520** | $ 2,094,354 | $ 2,200,060 |
| Corporate debt | **20,213,213** | **20,479,745** | 15,991,497 | 16,453,009 |
| Co-operative deposits | **5,000,000** | **5,223,544** | 7,329,777 | 7,734,737 |
| Co-operative securities | **4,125** | **4,125** | 4,125 | 4,125 |
| Corporate shares | **50,000** | **173,700** | 50,000 | 165,200 |
| | **$ 27,337,558** | **$ 28,032,634** | $ 25,469,753 | $ 26,557,131 |

## 6. Loans and mortgages

| | Total Loans | Impaired Loans | Total Allowance | Specific Allowance (included in total allowance) | Net Loans |
|---|---|---|---|---|---|
| **2012** | | | | | |
| Residential insured | **$ 315,665,957** | **$ -** | **$ 189,160** | **$ -** | **$ 315,476,797** |
| Residential uninsured | **95,524,753** | **10,104** | **414,239** | **10,104** | **95,110,514** |
| Non-residential | **97,689,818** | **731,931** | **985,816** | **19,116** | **96,704,002** |
| Real estate held for sale | **1,117,699** | **-** | **-** | **-** | **1,117,699** |
| | **509,998,227** | **742,035** | **1,589,215** | **29,220** | **508,409,012** |
| Less: under administration | | | | | |
| Residential insured | **77,297,448** | **-** | **-** | **-** | **77,297,448** |
| Residential uninsured | **7,902,893** | **-** | **-** | **-** | **7,902,893** |
| Non-residential | **4,512,268** | **-** | **-** | **-** | **4,512,268** |
| | **89,712,609** | **-** | **-** | **-** | **89,712,609** |
| | **$ 420,285,618** | **$ 742,035** | **$ 1,589,215** | **$ 29,220** | **$ 418,696,403** |
| **2011** | | | | | |
| Residential insured | $ 310,548,589 | $ - | $ 187,503 | $ - | $ 310,361,086 |
| Residential uninsured | 101,190,612 | 248,315 | 451,097 | 17,099 | 100,739,515 |
| Non-residential | 106,043,423 | 1,353,435 | 1,283,627 | 267,285 | 104,759,796 |
| Real estate held for sale | 771,618 | - | - | - | 771,618 |
| | 518,554,242 | 1,601,750 | 1,922,227 | 284,384 | 516,632,015 |
| Less: under administration | | | | | |
| Residential insured | 75,519,732 | - | - | - | 75,519,732 |
| Residential uninsured | 7,713,136 | - | - | - | 7,713,136 |
| Non-residential | 5,490,235 | - | - | - | 5,490,235 |
| | 88,723,103 | - | - | - | 88,723,103 |
| | $ 429,831,139 | $ 1,601,750 | $ 1,922,227 | $ 284,384 | $ 427,908,912 |

| **Continuity of allowance for loan losses** | **2012** | 2011 |
|---|---|---|
| Allowance, beginning of year | **$ 1,922,227** | $ 2,003,206 |
| Recoveries | **(536)** | - |
| Loan loss provisions (recoveries) | **(332,476)** | (80,979) |
| Allowance, end of year | **$ 1,589,215** | $ 1,922,227 |

The following is an analysis of loans that are impaired or may become impaired based on the age of repayments outstanding:

| | **2012** | 2011 |
|---|---|---|
| 31 to 60 days | **$ 1,922,128** | $ 1,964,951 |
| 61 to 90 days | **438,651** | 639,495 |
| 91 to 180 days | **737,346** | 681,540 |
| over 180 days | **-** | 580,114 |
| | **$ 3,098,125** | $ 3,866,100 |

## 7. Fixed assets

| **2012** | **Leasehold Improvements** | **Furniture and Equipment** | **Total** |
|---|---|---|---|
| **Gross carrying amount** | | | |
| Balance at January 1 | **$ -** | **$ -** | **$ -** |
| Additions | **-** | **-** | **-** |
| Disposals | **-** | **-** | **-** |
| Balance at December 31 | **-** | **-** | **-** |
| **Accumulated depreciation** | | | |
| Balance at January 1 | **-** | **-** | **-** |
| Disposals | **-** | **-** | **-** |
| Depreciation | **-** | **-** | **-** |
| Balance at December 31 | **-** | **-** | **-** |
| **Carrying amount December 31** | **$ -** | **$ -** | **$ -** |

| **2011** | | | |
|---|---|---|---|
| **Gross carrying amount** | | | |
| Balance at January 1 | $ 34,200 | $ 111,362 | $ 145,562 |
| Additions | - | - | - |
| Disposals | (34,200) | (111,362) | (145,562) |
| Balance at December 31 | - | - | - |
| **Accumulated depreciation** | | | |
| Balance at January 1 | (10,545) | (60,144) | (70,689) |
| Disposals | 13,965 | 93,716 | 107,681 |
| Depreciation | (3,420) | (33,572) | (36,992) |
| Balance at December 31 | - | - | - |
| **Carrying amount December 31** | $ - | $ - | $ - |

## 8. Capital stock

Authorized capital stock is unlimited. The amounts outstanding are as follows:

| | **Outstanding** | | | |
|---|---|---|---|---|
| | **2012** | | 2011 | |
| | **Shares** | **Amount** | Shares | Amount |
| Common shares, no par value, voting | 2,110,057 | **$ 2,110,057** | 500,000 | $ 500,000 |
| Class A preferred shares, no par value, non-cumulative, redeemable, non-retractable, voting | 13,986,740 | **13,986,740** | 13,986,740 | 13,986,740 |
| Class B preferred shares, no par value, non-cumulative, non-voting | | **-** | 1,510,057 | 1,510,057 |
| | | **$ 16,096,797** | | $ 15,996,797 |

Effective December 31, 2012, all of the $1,510,057 in Class B preferred shares were converted into $1,510,057 common shares. Other than the conversion noted above, the consideration for any shares issued or redeemed is cash. The Class A preferred shares are redeemable by the Company at a redemption rate of $1 per share after the fifth anniversary of the date of issue, subject to OSFI approval.

## 9. Financial instruments

### *a) Interest rate risk*

The Company earns and pays interest on certain assets and liabilities. To the extent that the assets, liabilities and financial instruments mature or reprice at different points in time, the Company is exposed to interest rate risk. The table below summarizes carrying amounts of balance sheet instruments by the earlier of the contractual repricing or maturity dates.

An estimate of prepayments has been determined by management and includes the estimated principal portion of regular mortgage payments and full payouts of mortgage loans during their term based upon historical trends for these types of payments.

| (Reported in $000's) | Within 3 Months | 3 Months to 1 Year | 1 Year to 5 Years | Over 5 Years | Non-interest Sensitive | Total | Average Rate |
|---|---|---|---|---|---|---|---|
| **2012** | | | | | | | **%** |
| Assets | | | | | | | |
| Cash and investments | $ **2,501** | $ **1,932** | $ **22,851** | $ **-** | $ **819** | $ **28,103** | **3.17** |
| Loans | **24,260** | **76,736** | **319,289** | **-** | **(1,589)** | **418,696** | **4.79** |
| Other assets | **-** | **-** | **-** | **-** | **3,518** | **3,518** | |
| | $ **26,761** | $ **78,668** | $ **342,140** | $ **-** | $ **2,748** | $ **450,317** | |
| Liabilities and equity | | | | | | | |
| Borrowings | $ **4,920** | $ **-** | $ **-** | $ **-** | $ **-** | $ **4,920** | **3.00** |
| Deposits | | | | | | | |
| Fixed | **32,704** | **134,890** | **211,224** | **-** | **-** | **378,818** | **2.38** |
| Variable | **14,352** | **-** | **-** | **-** | **-** | **14,352** | **0.56** |
| Mortgage backed securities | **-** | **-** | **5,461** | **-** | **-** | **5,461** | **2.08** |
| Other liabilities | **-** | **-** | **-** | **-** | **7,030** | **7,030** | |
| Equity and subordinated debentures | **-** | **-** | **-** | **-** | **39,736** | **39,736** | |
| | $ **51,976** | $ **134,890** | $ **216,685** | $ **-** | $ **46,766** | $ **450,317** | |
| Subtotal | $ **(25,215)** | $ **(56,222)** | $ **125,455** | $ **-** | $ **(44,018)** | $ **-** | |
| Prepayment estimate | **11,973** | **35,920** | **(47,893)** | **-** | **-** | **-** | |
| Excess (deficiency) | $ **(13,242)** | $ **(20,302)** | $ **77,562** | $ **-** | $ **(44,018)** | $ **-** | |

| | Within 3 Months | 3 Months to 1 Year | 1 Year to 5 Years | Over 5 Years | Non-interest Sensitive | Total | Average Rate |
|---|---|---|---|---|---|---|---|
| **2011** | | | | | | | % |
| Assets | | | | | | | |
| Cash and investments | $ 2,331 | $ 4,482 | $ 18,603 | $ - | $ 1,164 | $ 26,580 | 3.90 |
| Loans | 24,072 | 80,112 | 325,647 | - | (1,922) | 427,909 | 5.22 |
| Other assets | - | - | - | - | 5,421 | 5,421 | |
| | $ 26,403 | $ 84,594 | $ 344,250 | $ - | $ 4,663 | $ 459,910 | |
| Liabilities and equity | | | | | | | |
| Borrowings | $ 13,578 | $ - | $ - | $ - | $ - | $ 13,578 | 3.00 |
| Deposits | | | | | | | |
| Fixed | 33,559 | 146,277 | 205,296 | - | - | 385,132 | 2.57 |
| Variable | 13,500 | - | - | - | - | 13,500 | 1.00 |
| Other liabilities | - | - | - | - | 8,973 | 8,973 | |
| Equity and subordinated debentures | - | - | - | - | 38,727 | 38,727 | |
| | $ 60,637 | $ 146,277 | $ 205,296 | $ - | $ 47,700 | $ 459,910 | |
| Subtotal | $ (34,234) | $ (61,683) | $ 138,954 | $ - | $ (43,037) | $ - | |
| Prepayment estimate | 12,212 | 36,635 | (48,847) | - | - | - | |
| Excess (deficiency) | $ (22,022) | $ (25,048) | $ 90,107 | $ - | $ (43,037) | $ - | |

## *b) Interest rate swap agreements*

The Company may enter into interest rate swap agreements as a component of its overall risk management strategy. These agreements are contractual arrangements between two parties to exchange a series of cash flows. In an interest rate swap agreement, counterparties generally exchange fixed and floating rate interest payments based on a notional value. Typically, the floating rate is reset periodically, and the net interest amount is exchanged between the counterparties at scheduled dates.

The primary risks associated with these contracts are the exposure to movements in interest rates and the ability of the counterparties to meet the terms of the contract. Interest rate swap agreements are used to manage interest rate risk by modifying the repricing or maturities of assets and liabilities. Interest rate swap agreements are considered financial derivatives and are recorded at fair value. Income and expenses on interest rate swap agreements are recognized over the life of the contract as an adjustment to interest expense. Accrued expenses are recorded in accrued interest payable. There were no interest rate swap agreements outstanding at December 31.

### *c) Fair value*

The following table presents the fair value of on and off balance sheet financial instruments of the Company based on the valuation methods and assumptions set out below. Fair value represents the amount at which a financial instrument could be exchanged in an arm's length transaction between willing parties under no compulsion to act and is best evidenced by a quoted market price, if one exists. Quoted market prices are not available for a significant portion of the Company's financial instruments.

The fair values disclosed exclude the values of assets and liabilities that are not considered financial instruments such as prepaid expenses. In addition, items such as the value of intangible assets such as customer relationships which, in management's opinion add significant value to the Company, are not included in the disclosures below.

A three-tier hierarchy is used as a framework for disclosing fair values based on inputs used to value the Company's financial instruments recorded at fair value. Valuation methods used in this framework are categorized under the following fair value hierarchy:

- Level 1 – Quoted prices for active markets for identical financial instruments.
- Level 2 – Quoted prices for similar instruments in active markets; quoted prices for identical or similar financial instruments in markets that are not active; and model-derived valuations in which all significant inputs are observable in active markets.
- Level 3 – Valuations derived from valuation techniques in which one or more significant inputs are not based on observable market data.

The carrying value of cash and cash equivalents approximate their fair value as they are short term in nature or are receivable on demand. For investments, corporate shares are valued using quoted market prices (Level 1); bonds and co-operative deposits are valued using market prices provided by third party brokers (Level 2); and co-operative securities are carried at cost. There have been no transfers between Level 1 and 2 during the year.

For variable rate loans and deposits the carrying value is also considered to be a reasonable estimate of fair value. For fixed rate loans and mortgages, deposits, and mortgage backed securities, the fair value is calculated using a discounted cash flow model, based on weighted average interest rates and the term to maturity of the instrument. The discount rates applied were based on the current market rate offered for the average remaining term to maturity.

The calculation of estimated fair values is based on market conditions at a specific point in time and may not be reflective of future fair values.

| | 2012 Cost | 2012 Estimated Fair Value | 2011 Cost | 2011 Estimated Fair Value |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and cash equivalents | **$ 69,708** | **$ 69,708** | $ 22,744 | $ 22,744 |
| Investments | **27,337,558** | **28,032,634** | 25,469,753 | 26,557,131 |
| Loans and mortgages | **418,696,403** | **431,998,794** | 427,908,912 | 435,307,083 |
| Accrued interest | **1,231,075** | **1,231,075** | 1,320,396 | 1,320,396 |
| | | | | |
| **Liabilities** | | | | |
| Borrowings | **$ 4,919,583** | **$ 4,919,583** | $ 13,578,441 | $ 13,578,441 |
| Deposits | **393,170,044** | **396,163,678** | 398,632,390 | 406,049,479 |
| Accrued interest | **4,123,668** | **4,123,668** | 4,386,366 | 4,386,366 |
| Mortgage backed securities | **5,460,960** | **5,460,960** | - | - |

## 10. Related party transactions

### Parent

The Company has a contract with its parent, Atlantic Central (Central), for the receipt of administrative, management and other services. The Companies also transact other business in the ordinary course of operations. The following transactions and balances are measured at the exchange amount:

| | 2012 | 2011 |
|---|---|---|
| Expenses and fees related to the management contract | **$ 2,739,000** | $ 2,220,000 |
| Interest income | **208,046** | 202,841 |
| Interest expense | **502,185** | 650,899 |
| Rental and other expenses | **297,860** | 318,177 |
| Dividends | **15,000** | 15,000 |
| Deposits at Central | **5,000,000** | 5,000,000 |
| Borrowings from Central | **4,919,583** | 13,578,441 |
| Deposits from Central | **31,882,877** | 31,765,047 |
| Accounts payable to Central | **373,251** | 651,338 |
| Fixed assets sold to Central | **-** | 37,881 |
| Common shares issued to Central | **100,000** | - |
| | | |
| Balances relating to mortgages sold: | | |
| Interest net of administration fees | **386,621** | 545,251 |
| Mortgages under administration | **7,612,829** | 9,955,163 |
| Obligations related to mortgages | **535,027** | 428,229 |

**Associates**

In the ordinary course of business, the Company transacts business with League Data Limited, a related company by virtue of common ownership. The following transactions and balances are measured at the exchange amount:

| | | 2012 | | 2011 |
|---|---|---|---|---|
| Computer services expense | **$** | **327,005** | $ | 289,504 |

**Key management personnel**

Key management personnel include members of the Board of Directors, the President and CEO, and other senior officers of the Company and their spouses. A portion of the compensation paid to key management is paid by the Parent, with costs being allocated between the Company and the Parent through a management fee. The components of total compensation received by key management personnel (including amounts paid by the Parent), and balances due to/from key management personnel are as follows:

| | | 2012 | | 2011 |
|---|---|---|---|---|
| Short-term employee benefits | **$** | **1,144,463** | $ | 831,828 |
| Contributions to a group savings for retirement program | | **78,448** | | 56,125 |
| Variable compensation | | **230,022** | | 175,606 |
| Retirement allowance | | **154,000** | | - |
| Mortgage balances due from key management | | **106,675** | | 125,446 |
| Deposit balances due to key management | | **1,686,550** | | 1,524,543 |

The President and CEO, and each of the 5 (2011 - 3) other senior officers of the Company earned variable compensation during the year. The Company's Total Compensation Program does not include guaranteed bonuses or deferred compensation payments. Variable compensation is earned during the year and paid in cash in the following year.

Short-term employee benefits include salaries, director remuneration and other benefits. The mortgage and deposit transactions were made in the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with persons of a similar standing or, where applicable, with other employees. The transactions did not involve more than the normal risk of repayment or present other unfavourable features.

Payments to Directors are as follows:

| | | 2012 | | 2011 |
|---|---|---|---|---|
| Remuneration | **$** | **57,500** | $ | 57,500 |
| Payments for reimbursement of expenses | | **40,130** | | 34,787 |

**11. Commitments and contractual obligations**

***a) Management fees***

Atlantic Central provides services under the following services agreements:

| | Expires | Renewal | Fees |
|---|---|---|---|
| Executive Agreement | 2014 | Automatic renewal for 5 years | $250,000 |
| Management Agreement | 2013 | Automatic renewal for 1 year term | Amount determined annually |
| Information Technology Services | 2014 | Automatic renewal for 5 years | Amount determined annually |

***b) Approved mortgages***

At December 31, 2012 the Company had approved mortgages in the amount of $7,811,287 (2011 - $12,043,612) which have not been advanced.

***c) Rental of premises***

The Company has entered into an operating lease for premises in Sydney. The Company is committed to pay annual lease payments for rental space for premises as follows:

| 2013 | 2014 | 2015 | 2016 | 2017 | After 5 Years |
|---|---|---|---|---|---|
| **$ 53,125** | **$ 53,125** | **$ 53,125** | **$ 53,125** | **$ 30,990** | **$ -** |

Lease payments of $65,240 were recognized as an expense during the period, including minimum lease payments of $53,125 and contingent costs of $12,115.

The Sydney lease includes a requirement to pay basic rent of $25 per rentable square foot and additional rent of the Company's proportionate share of all increases in operating costs over $9.50 per rentable square foot

of the premises, determined at the commencement of each calendar year. The original term of the lease is from August 1, 2007 to July 31, 2012, and there was an option to extend the lease for further consecutive five year terms, which was exercised in 2012.

## 12. Taxes

The components of tax expense are as follows:

| | | 2012 | | 2011 |
|---|---|---|---|---|
| Current tax expense | | | | |
| Federal and provincial | $ | **654,151** | $ | 1,142,377 |
| Capital and Large Corporate Tax | | **308,847** | | 217,880 |
| | | **962,998** | | 1,360,257 |
| Deferred tax expense | | | | |
| Origination and reversal of deductible temporary differences | | **33,294** | | 6,032 |
| Reduction in tax rate | | **2,480** | | 26,566 |
| | | **35,774** | | 32,598 |
| Total tax expense | $ | **998,772** | $ | 1,392,855 |

The provision for income taxes differs from the result which would be obtained by applying the combined Canadian Federal and Provincial statutory income tax rates to income before taxes. This difference results from the following:

| | | 2012 | | 2011 |
|---|---|---|---|---|
| Income before income taxes | $ | **2,617,850** | $ | 3,863,161 |
| Statutory income tax rate | | **42.71%** | | 42.94% |
| Expected income tax | | **1,118,084** | | 1,658,841 |
| Effect on income tax of: | | | | |
| Non-taxable dividends | | **(3,027)** | | (3,030) |
| Permanent tax differences | | **5,116** | | 6,046 |
| Capital and Large Corporate Tax | | **176,940** | | 124,314 |
| General tax rate reduction | | **(300,806)** | | (420,015) |
| Future tax rate reduction | | **2,480** | | 26,566 |
| Other | | **(15)** | | 133 |
| Total income tax expense | $ | **998,772** | $ | 1,392,855 |

The movement in deferred tax assets and liabilities are:

| | Balance December 31 2010 | Recognized in: Net Income | OCI | Balance December 31 2011 | Recognized in: Net Income | OCI | Balance December 31 2012 |
|---|---|---|---|---|---|---|---|
| Deferred tax assets | | | | | | | |
| Property and equipment | $ 29,812 | $ 7,699 | $ - | $ 37,511 | **$ (2,926)** | **$ -** | **$ 34,585** |
| Allowance for impaired loans | 539,990 | (42,921) | - | 497,069 | **(32,848)** | **-** | **464,221** |
| Losses carried forward | 148 | - | - | 148 | **-** | **-** | **148** |
| Other | 124 | (124) | - | - | **-** | **-** | **-** |
| | 570,074 | (35,346) | - | 534,728 | **-** | **-** | **498,954** |
| Deferred tax liabilities | | | | | | | |
| Unrealized gains on investments | (2,747) | 2,747 | - | - | **-** | **-** | **-** |
| | (2,747) | 2,747 | - | - | **-** | **-** | **-** |
| Net deferred tax asset | $ 567,327 | $ (32,599) | $ - | $ 534,728 | **$ -** | **$ -** | **$ 498,954** |

## 13. Capital requirements

The Company manages its capital under guidelines established by the Office of the Superintendent of Financial Institutions (OSFI), which require the Company to maintain capital ratios that are adequate in relation to their levels of business activity. OSFI has issued its guidelines based on standards issued by the Bank for International Settlements, Basel Committee of Banking Supervisors (BCBS). OSFI has adopted capital guidelines based on the standards known as Basel II, which became effective for League Savings in 2008. Pillar 1 of the Basel II framework defines minimum capital requirements, while Pillar 2 addresses standards for the management of capital requirements.

Capital requirements are determined based on exposures to credit risk, operational risk, and for entities with significant trading activity, market risk. The standards provide different methodologies for the calculation of risk exposures based on a company's relative size and sophistication. The Company has implemented the Standardized Approach for credit risk, and the Basic Indicator Approach (BIA) for operational risk. The Company is not subject to the requirements for market risk.

Regulatory capital is allocated to two tiers: Tier 1 and Tier 2. Tier 1 comprises the more permanent components of capital and consists primarily of common shares, non-cumulative preferred shares, retained earnings and contributed surplus. Tier 2 capital, which is primarily composed of subordinated notes, is limited to 50% of Tier 1. Based on Pillar 1 of the Basel II framework, OSFI has established two standards: maximum assets to capital multiple and a minimum risk based capital ratio. The first test provides an overall measure of the adequacy of a Company's capital. The second measure focuses on risk faced by the Company.

Pillar 2 of the Basel II framework requires that institutions have a process in place to make an internal assessment of its overall capital position relative to its own unique circumstances and risk profile. This process, referred to as ICAAP, is approved by the Company's Board. The Company sets internal capital requirements

that are calculated in accordance with the approved ICAAP. In particular, the Company's internal capital limits are adjusted based on an annual assessment of the Company's risk profile as identified in an Enterprise Risk Management framework. These internal limits provide for capital that is in excess of the regulatory minimums.

Capital ratios are monitored regularly and reported to the Board quarterly. The Capital Management Plan, which forecasts capital requirements and includes contingency plans in the event of unanticipated changes, is reviewed by the Board annually. Details of the Company's regulatory capital at December 31 were as follows:

| | **2012** | 2011 |
|---|---|---|
| Risk-weighted assets for: | | |
| Credit risk | **$ 127,490,000** | $ 154,606,000 |
| Operational risk | **24,788,000** | 25,175,000 |
| Total | **$ 152,278,000** | $ 179,781,000 |
| Capital elements: | | |
| Common shares | **$ 2,110,000** | $ 500,000 |
| Contributed surplus | **1,786,000** | 1,786,000 |
| Retained earnings | **14,329,000** | 13,146,000 |
| Common equity tier 1 | **18,225,000** | 15,432,000 |
| Preferred shares | **13,987,000** | 15,497,000 |
| Total tier 1 | **32,212,000** | 30,929,000 |
| Subordinated debentures | **7,102,000** | 7,102,000 |
| Unrealized gain on AFS investments | **75,000** | 69,000 |
| Tier 2 capital | **7,177,000** | 7,171,000 |
| Total regulatory capital | **$ 39,389,000** | $ 38,100,000 |
| Ratios: | | |
| Common equity tier 1 | **11.97%** | 8.58% |
| Total tier 1 | **21.15%** | 17.20% |
| Total capital | **25.87%** | 21.19% |
| Assets to capital multiple | **11.43** | 12.07 |
| OSFI targets (a): | | |
| Common equity tier 1 | **n/a** | n/a |
| Total tier 1 | **7.00%** | 7.00% |
| Total capital | **10.00%** | 10.00% |
| Assets to capital multiple | **20** | 20 |

(a) New OSFI targets effective January 1, 2013, including a new common equity tier 1 target of 7%, are detailed below.

The Company's capital ratios have been in compliance with the regulatory requirements throughout the year.

## Future changes in capital requirements

In December 2010, the BCBS published the final rules on new international bank capital adequacy and liquidity requirements. Commonly referred to as "Basel III", the capital proposals aim to provide a regulatory framework to strengthen the resiliency of the banking sector and financial system.

In January 2011, the final rules were supplemented by additional guidance from the BCBS regarding Non-Viability Contingent Capital (NVCC). The NVCC rules require that all capital instruments include loss absorption features. The Basel III rules provide for a transition and phase-out for capital instruments that do not meet the Basel III requirements, including the NVCC features.

In December 2012, OSFI issued its revised guideline for Capital Adequacy Requirements, effective January 2013, based on the Basel II and Basel III framework. The revised guidelines include new minimum capital requirements, and phase-in and phase-out requirements for capital adjustments over a transition period from 2013 to 2019. The minimum capital requirement in effect on January 1, 2013 include a 7% Common Equity Tier 1 target ratio (4.5% minimum plus a 2.5% capital conservation buffer), an 8.5% target for Total Tier 1 Capital, and a 10.5% target for Total Capital. Common Equity Tier 1 is considered the highest quality of capital and is primarily made up of Common Shares and Retained Earnings.

## 14. Credit facilities

The Company has established an unsecured operating line of credit with Atlantic Central, bearing interest at prime, up to an amount of $20,000,000. At December 31, 2012 the amount outstanding on this facility was $4,919,583 (2011 - $13,578,441). The Company has also established a line of credit with Central 1 secured by an assignment of residential mortgages, bearing interest at prime, up to an amount of $25,000,000. At December 31, 2012 and 2011 the amount outstanding on this facility was nil.

## 15. Deposits

| | | **2012** | | 2011 |
|---|---|---|---|---|
| Registered | **$** | **7,512,180** | $ | 7,023,201 |
| Other deposits | | **6,839,482** | | 6,476,931 |
| Total demand | | **14,351,662** | | 13,500,132 |
| Registered | | **169,428,570** | | 163,598,038 |
| Other term deposits | | **209,389,812** | | 221,534,220 |
| Total term | | **378,818,382** | | 385,132,258 |
| | **$** | **393,170,044** | $ | 398,632,390 |

## 16. Assets under administration

Assets under administration include mortgages under administration, which are not the property of the Company and are not reflected in the balance sheet. At December 31, the Company had assets under administration as follows:

| | | 2012 | | 2011 |
|---|---|---|---|---|
| Mortgages under administration | **$** | **89,712,609** | $ | 88,723,103 |

## 17. Subordinated debentures

Series B debentures are unsecured and subordinated to all other indebtedness of the Company. The minimum interest rate is equal to 1.5 times the dividend rate on the Preferred A shares. Series B debentures are convertible into Preferred A shares at the option of the holder and redeemable at the option of the Company after the fifth anniversary of the date of issue, subject to the approval of the Office of the Superintendent of Financial Institutions.

| | Maturity Date | Earliest Redemption | | 2012 | | 2011 |
|---|---|---|---|---|---|---|
| Series B | December 31, 2024 | December 31, 2009 | **$** | **7,102,000** | $ | 7,102,000 |

During the year there were no subordinated debentures issued or redeemed.

## 18. Non-interest income (expense)

Non-interest income (expense) includes the following:

| | | 2012 | | 2011 |
|---|---|---|---|---|
| Lending services fees | **$** | **1,252,883** | $ | 1,807,945 |
| Lending services expenses | | **(1,088,230)** | | (739,548) |
| Investment services fees | | **26,995** | | 35,096 |
| Investment services expenses | | **(530,977)** | | (513,402) |
| Other | | **34,416** | | 50,884 |
| | **$** | **(304,913)** | $ | 640,975 |

The expenses detailed above include direct expenses only. Salary and staff related costs, and other indirect costs required to provide these services, are reported in operating expenses.

## 19. Mortgage backed securities

Balances relating to mortgage backed securities under the NHA MBS program are as follows:

| | | 2012 | | 2011 |
|---|---|---|---|---|
| Carrying value of NHA MBS assets | $ | **5,491,326** | $ | - |
| Carrying value of associated liabilities | | **5,460,960** | | - |

## 20. Compensation

Compensation is a key factor in recruiting, retaining, motivating and rewarding a talented and committed workforce. Pay determination policies and guidelines emphasize continued development of knowledge, expansion of skills, performance and the ability to be flexible and adaptable to change.

The goals of our Total Compensation Program are to provide levels of compensation that are internally equitable, externally competitive, financially feasible, and that will enable the Company to attract, retain and reward highly qualified individuals. Total Compensation includes base pay, variable pay (which must be re-earned each year) and employee benefits.

The Executive/HR Committee of the Board of the parent company is responsible for:

- Establishing an annual performance plan with specific objectives and monitoring and conducting annual performance evaluations of the President & CEO against these objectives.
- Determining and recommending to the Board an appropriate total compensation package (including variable compensation) for the President & CEO.
- Reviewing annually the terms and conditions of the variable compensation plan for employees and recommending adoption by the Board.

The Board has delegated to the President & CEO the responsibility for the implementation and administration of all management or executive policies, including the Total Compensation Program for employees. The variable compensation program is governed by the Performance Sharing Incentive Plan, which is based on the following principles:

- The President & CEO will have the ultimate discretion to determine whether payment occurs and what the payment will be for the year based on the annual performance of the Company.
- Company performance is evaluated based on financial, customer service, and balanced scorecard results.
- The plan is self-funded – if the Company does not achieve the designated level of financial performance there will be no payout under the plan.

- Individual performance will determine participation in, and individual payments under the plan. Individual performance is measured against annual individual performance plans.

Compensation to members of the Board of Directors is limited to an annual honorarium. Directors do not participate in any variable compensation programs. Compensation paid to Directors and key management personnel are detailed in Note 10 – related party transactions.

## Governance

Sound governance and ethical behaviour begins with our Board of Directors, which represents and is accountable to our shareholders and assumes responsibility for the stewardship of League Savings and Mortgage Company. The Board of Directors is responsible for overseeing the management of the business and affairs of League Savings with the objective of enhancing both shareholder and stakeholder value. Among its many specific duties, the Board of Directors approves strategic plans and objectives, provides advice, counsel and oversight to the President & Chief Executive Officer, oversees the ethical, legal and social conduct of League Savings and Mortgage Company, oversees the risk management of the Company and reviews the Company's ongoing financial performance.

## Board Composition

The Board of Directors ensures that appropriate structures and procedures are in place so that it functions independently of management. In 2012, the Board of Directors was comprised of 11 Directors, two elected at large from New Brunswick, one elected at large from each of Newfoundland and Labrador, Nova Scotia and Prince Edward Island and six representatives appointed by the company's parent, Atlantic Central. However, during the Annual General Meeting held in 2012, the shareholders resolved to amend the By-laws of League Savings to provide that, effective April 2014, one of the two Director positions currently elected from New Brunswick will instead be elected at-large by all of the Preferred A Shareholders. Directors are elected for three-year terms, and no employee may sit as a Director.

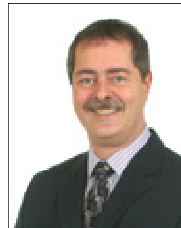
The following individuals currently serve as the Board of Directors of League Savings and Mortgage Company:

Jim MacFarlane, Chair of the Board

Raymond Surette, Vice-Chair

Ron Andrews

Doug Dewling


Dan Honnor

Marc LeClair

Kevin MacAdam

Tammy Christopher

Charles Parker

John Peach

Ken Shea

The Board of Directors and each committee regularly meet once each quarter. The Board of Directors also holds an annual strategic planning session. The Board of Directors meets at other times when matters requiring its approval or consideration are raised and it is not possible or prudent to wait for the next regularly scheduled meeting. The Board of Directors met five times in 2012.

## Committees of the Board

The Board of Directors has established three standing committees: Executive; Audit, Risk and Conduct Review; and Governance.

***Executive Committee***: Its three members include the Board Chair, Vice-Chair and one Director elected by the Board. This Committee is responsible for addressing matters in between scheduled Board meetings that require immediate attention, and for approving credit applications that are above management lending limits.

*Committee Members*: Jim MacFarlane (Chair), Raymond Surette (Vice-Chair) and Dan Honnor.

***Audit, Risk and Conduct Review Committee***: The Committee is made up of five members. As an Audit Committee, it is responsible to ensure that management has designed and implemented an effective system of financial management and related internal controls. It also reviews and reports on the audited financial statements and ensures compliance with certain regulatory and statutory requirements. It is also responsible to meet periodically with internal and external auditors. As a Risk Committee, it is responsible for ensuring that management has developed and maintained an effective Enterprise Risk Management Framework for evaluating the business strategies being used for allocation of human, capital and other resources. As a Conduct Review Committee, it is responsible to ensure that League Savings has developed and adheres to ethical standards and sound business conduct in such areas as conflict of interest and related party procedures.

*Committee Members*: Doug Dewling (Chair), Marc LeClair, Dan Honnor, Ron Andrews and Tammy Christopher.

***Governance Committee***: Its five members are responsible for reviewing and recommending changes, as appropriate, to the governance structure of League Savings and Mortgage Company and for ensuring that an effective governance system is in place including a schedule for regular policy review and compliance. In addition, this Committee ensures Board of Directors decisions and positions are appropriately translated into documented policies. Policies developed by the Committee are forwarded to the Board of Directors for its consideration and approval. The Committee oversees the nomination process for the Board of Directors. The Committee is responsible for overseeing the Director evaluation process, and for establishing and monitoring the orientation program for new Directors, and the ongoing training and development of Directors.

*Committee Members*: Ken Shea (Chair), Raymond Surette, Kevin MacAdam, Charles Parker and John Peach.

## Attendance at Board and Committee Meetings

The Board of Directors recognizes the importance of each individual Director's participation at Board and Committee meetings. Every Director is expected to attend all Board and Committee meetings unless adequate cause is given for missing a meeting. The table following sets out the attendance of each Director at Board and Committee meetings throughout 2012:

| Name | Board and Planning Session | Audit, Risk & Conduct Review Committee | Executive/HR Committee | Governance Committee |
|---|---|---|---|---|
| * Jim MacFarlane | 5/5 | - | - | - |
| * Raymond Surette | 4/5 | - | - | 4/4 |
| Ron Andrews | 5/5 | 5/5 | - | - |
| Marc LeClair | 5/5 | 5/5 | - | - |
| Charles Parker | 5/5 | - | - | 3/4 |
| John Peach | 5/5 | - | - | 4/4 |
| Ken Shea | 5/5 | - | - | 4/4 |
| Dan Honnor | 4/5 | 5/5 | - | - |
| Doug Dewling | 5/5 | 5/5 | - | - |
| Kevin MacAdam | 5/5 | - | - | 4/4 |
| Tammy Christopher | 4/4 | 4/4 | - | - |

* Table Officers

## Board Evaluations

As part of its commitment to ongoing development and improvement, the Board of Directors conducts an annual self-evaluation. This evaluates the Board of Director's effectiveness in the following areas: Financial Performance, Relationship with Credit Union System, Board Functioning, Strategic Leadership, Corporate Social Responsibility, Governance, Learning and Development. The results of the evaluation are used to guide the training and development agenda for the Board of Directors in the upcoming year.

## Evolving Governance Practices

At League Savings and Mortgage Company, we recognize that our governance standards must not only evolve to respond to changes in our company, stakeholder expectations and regulatory requirements, but also to ensure that League Savings and Mortgage Company and its stakeholders receive the benefit of exceptional governance practices. The Board of Directors and management continually monitor developments in corporate governance and are committed to ongoing training and development to ensure that League Savings and Mortgage Company continues to lead the credit union network with its governance practices.

**League Savings and Mortgage Company**
Halifax
Riverview
Sydney

**www.lsm.ca**