RFA

BANK OF CANADA

BASEL III PILLAR 3 DISCLOSURES

JUNE 30, 2024

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NATURE OF OPERATIONS

RFA Bank of Canada ("RFA Bank" or the "Bank") is a Canadian federally regulated Schedule I bank. The Bank takes deposits in the form of guaranteed investment certificates ("GICs"), its business activities are concentrated in the following three lines of lending business: residential mortgage (1-4 units), Commercial Real Estate (CRE) loans (comprising commercial lending including multi-unit residential – 5+ units, retail, industrial and office space), Construction loans (including Land Acquisition, Development and Construction). The address of its registered office is 1 Yonge Street, Suite 2401, Toronto, Ontario, M5E 1E5.

BASIS OF PREPARATION

These Basel III Pillar 3 Disclosures (the "Disclosures"), which are unaudited, are made pursuant to the Office of the Superintendent of Financial Institutions ("OSFI") requirements and are based on the global standards that have been established by the Basel Committee on Banking Supervision ("BCBS"). RFA Bank is a Category 2 small and medium-sized deposit taking institution ("SMSB") for purposes of capital and liquidity requirements. The amounts presented are based on the Bank's annual and interim financial statements, which are prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). Additional financial information is available on OSFI's website at https://www.osfi-bsif.gc.ca/Eng/wt-ow/Pages/fd-df.aspx. Full qualitative disclosures are also provided annually on the Q4 report.

RISK MANAGEMENT

The Bank is exposed to various types of risk owing to the nature of its business activities, and, like other financial institutions, is exposed to the symptoms and effects of domestic and global economic conditions and other factors that could adversely affect its business, financial condition, and operating results. Many of these risks cannot be directly controlled by the Bank.

Risk Management is an integral component of the Bank and supports the achievement of sustainable growth and returns while maintaining an appropriate balance between risk and return. The key risks faced by the Bank can be categorized into financial risks (such as credit, market, liquidity and funding, and capital adequacy), and non-financial risks (such as strategic, operational, reputational, and regulatory and legal). The Bank's risk management practices include risk governance, the risk appetite and enterprise risk management framework, risk assessment, controls, gap identification and remediation, monitoring and reporting. These risk practices are continually reviewed and enhanced.

Risk Governance

The Board of Directors ("the Board" or "Board") is responsible for providing strategic direction, guidance, and oversight across the Bank, including the Bank's Enterprise Risk Management ("ERM") and risk appetite frameworks. The risk appetite framework reflects the aggregate level and type of risk that the Bank is willing to accept or to avoid, in order to achieve its business objectives. The Bank's ERM process involves the Bank's Board of Directors, management and their risk committees, and other personnel. It is applied in strategy-setting and across the Bank, designed to identify potential events that may affect the Bank, and manage risk to be within the risk appetite, and provide reasonable assurance regarding the achievement of objectives.

The Bank’s risk governance follows the Three Lines of Defense model:

- *First line of defense* - Employees within each business line owns the risk, each area will identify, accept, mitigate, and manage risk on a day-to-day basis, adhering to the established Residential and Commercial Mortgage Underwriting and risk appetite policies and supporting guidelines of the Bank. This is also referred to as operational management.

- *Second line of defense* - The risk management, compliance and finance functions represented by the Chief Risk Officer, Chief Compliance Officer, and Chief Financial Officer respectively, establish policy and provide direction, guidance, methodology, tools and independent monitoring and analysis of first line of defense risk taking and risk management activities. The oversight functions are responsible for providing enterprise-wide oversight of operational management. These groups are also referred to as oversight management.

- *Third line of defense* - Internal audit provides independent assurance on the adequacy and effectiveness of the ERM framework with the supporting practices and compliance of the first and second lines of defense. The Bank’s Chief Internal Auditor reports directly to the Audit Committee and administratively to the Chief Executive Officer.

The Bank’s risk profile is measured against the Board-approved risk appetite and reported to the Board of Directors at least quarterly. Board approved policies are reviewed at least annually and updated as required.

Risk Reporting

The Enterprise Risk Management (“ERM”) team provides monthly risk reports to the Senior Management Committee and/or its sub-committees and quarterly to the Board ERMC including the following information:

- Risk exposures against limits/thresholds, along with trends/direction of risks and significant risk positions,
- Limit violations and remedial action plans,
- Policy exceptions,
- Significant concentrations,
- Emerging risks,
- Significant risk events and actual/potential losses,
- Risk mitigation action plans and current status and,
- Status of risk management activities.

Roles and Responsibilities

The following roles and responsibilities have been established for managing risk across the Bank.

- Board of Directors, supported by their sub-committees

- Review and approve the Bank’s risk appetite and risk management frameworks and policies,
- Provide oversight of the risk management program ensuring that the processes in place to identify and manage risks are effective,
- Receive periodic risk reporting from the Bank on risk exposures and plans.

- Chief Executive Officer (CEO) supported by the Senior Management Committee (“SMC”) and its sub-committees
  - Reviews and recommends risk appetite and risk management frameworks and policies to the Board,
  - Reviews and approves risk management standards supporting Board-approved policies,
  - Oversees implementation of the risk management frameworks, policies, and standards to ensure effectiveness,
  - Promotes a strong risk culture through tone at the top, leadership, accountability, open and transparent communication and escalation of issues,
  - Ensures strategic objectives and plans align with the Bank’s stated risk appetite and that the risks relating to strategic initiatives are understood and managed,
  - Receives regular reporting on enterprise-wide risk exposures and escalates to the Board risks exceeding the Bank’s risk appetite.
- Chief Risk Officer (CRO) supported by the ERM & Compliance Teams
  - Recommends risk appetite/limits and risk management frameworks, policies and standards to the SMC and relevant sub committees,
  - Develops and implements risk management tools and methodologies and provides support to management for the identification, assessment, mitigation and monitoring of risks,
  - Provides independent challenge to management’s risk management activities, including policy/standard development, risk assessment and reporting,
  - Monitors risk across the Bank and escalates significant risks or concerns or incidents of non-compliance to the CEO,
  - Monitors changes in the business environment, including legal and regulatory requirements, and assesses impact on the Bank’s risk exposures,
  - Provides timely reporting on enterprise-wide risk exposures to the Senior Management Committee and the Board,
  - Provides risk management education, training, and advice.
- Other Oversight Functions (e.g., Finance and Human Resources)
  - Recommend policies and standards to the SMC for specific risks (e.g., HR – Finance – Capital Management),
  - Monitor and provide reporting on these risks and escalate significant risks or concerns or incidents of non-compliance to the CRO and CEO,
  - Provide education, training, and advice on these risks.
- Management (Risk Owners)

- Assumes ownership of the risks in their business
    - Manage day-to day-operations of their business and ensures that internal controls are designed and operating effectively,
    - Identify, assess, mitigate, measure, monitor, and report on risks in their areas of responsibility and adhere to the Bank's established risk appetite, policies, and standards,
    - Promote a risk management culture and establishes effective internal controls within their areas,
    - Complete risk mitigation action plans within proposed timelines and regularly reports status of action plans,
    - Escalates risks or concerns to the CRO in a timely manner.
- Internal Audit
    - Provide independent assurance on the effectiveness of governance, risk management and control processes including compliance with the ERM framework, related policies and practices, and regulatory requirements.

Enterprise Risk Appetite Statement

The Bank will:

- Only take risks that fit the business strategy and that can be understood and managed, and do not; result in significant earnings volatility or expose the Bank to any significant single loss event,
- Maintain adequate capital and a conservative liquidity profile that meet or exceed regulatory requirements,
- Avoid excessive concentrations of risk,
- Protect the Bank's reputation at all times with all key stakeholders,
- Conduct business with honesty, integrity, respect, and high ethical standards,
- Deal with trustworthy and reputable third parties after conducting appropriate due diligence and implementing ongoing oversight,
- Maintain financial and operational resilience for severe yet plausible events,
- Ensure sound management of operational and regulatory compliance risks and maintain a strong risk culture,
- Incorporate risk and compliance measures into performance and reward measurement programs and,
- Acquire strategic investments after conducting appropriate due diligence that considers risk, opportunity costs and impact on the Bank's capital ratio.

CAPITAL MANAGEMENT

As a regulated financial institution that is subject to the capital requirements of its regulator, OSFI, the Bank must continually monitor and assess its capital adequacy under both expected and stressed conditions. An adequate capital reserve provides the Bank with a buffer for reasonably foreseeable losses, ensures that the Bank may absorb such losses, and maintains the stability of the business. Capital adequacy can be affected by changes in the Bank's financial performance, its business plans, or regulatory requirements.

The Bank has a Board-approved Capital Management Policy ("CMP") and Capital Contingency Plan ("CCP") that are aligned with the Bank's ERM framework risk appetite and strategic plan. The CMP governs the quantity and quality of capital held and ensures that it meets regulatory capital requirements. Its overall objective is to ensure that the Bank appropriately balances its capital allocation between retention of a prudent margin above regulatory capital adequacy minimums, and maintenance of sufficient freely available capital to achieve business goals and objectives. The CCP sets out the actions the Bank would consider remediating for any current or prospective deficiencies in its capital position. The CMP and CCP are reviewed at least annually and more often if required by events or changing circumstances.

Capital adequacy risk is the risk that the Bank holds insufficient capital to meet regulatory requirements and any other requirements necessary to manage the organization as a going concern, including during periods of severe but plausible stress (such as rising interest rates or housing downturn). The Bank manages its capital risk through both the CMP and the utilization of an Internal Capital Adequacy Assessment Process ("ICAAP") in accordance with OSFI Guideline E-19.

The Bank calculates its capital ratios and regulatory capital based on the capital adequacy requirements issued by OSFI. The bank must maintain minimum levels of capital to meet minimum risk-based capital ratios. These are based on *Basel III: A global regulatory framework for more resilient banks and banking systems – A Revised Framework* ("Basel III") reforms. For a breakdown of the different elements of the Bank's capital, please refer to financial information available on OSFI's website at https://www.osfi-bsif.gc.ca/Eng/wt-ow/Pages/fd-df.aspx.

The Bank must maintain minimum levels of capital to meet minimum risk-based capital ratios based on Basel III reforms. The Bank's CMP addresses regulatory capital requirements including the Leverage Ratio and the Risk-Based Capital Ratios.

The Leverage Ratio is defined as the Capital Measure divided by the Exposure Measure, with the ratio expressed as a percentage. The Capital Measures are the Bank's all-in Tier 1 capital, and the Bank's Total Capital. The Exposure Measure consists of on-balance sheet, derivative, securities financing transactions and off-balance sheet exposures. The minimum leverage ratio for federally regulated deposit-taking institutions such as the Bank is 3%, and OSFI also establishes Leverage Ratio targets for each financial institution, which are confidential. The risk-based capital ratios are composed of the Common Equity Tier 1, Tier 2, and Total Capital Ratios. The Bank was fully compliant with its target regulatory capital and leverage ratio requirements as of June 30, 2024.

The Bank's risk-weighted assets are determined by applying the OSFI-prescribed rules to on-balance sheet and off-balance sheet exposures. They include all on-balance sheet assets weighted for the risk inherent in each asset type, an operational risk component based on a percentage of average annual adjusted gross income, and a component based on commitments for on-balance sheet lending. The Bank follows the Basel III Standardized Approach to calculate credit risk, and the Simplified Standardized Approach for operational risk.

Key regulatory metrics for the Bank and the components of the leverage ratio are shown in the tables below. During all periods presented, all capital ratios were above OSFI's stated minimum ratios. The Bank's leverage ratio was also above the minimum ratio that was assigned to the Bank by OSFI.

KEY METRICS

		Q2-2024	Q1-2024	Q4-2023	Q3-2023	Q2-2023
		T	T–1	T–2	T–3	T–4
	Available capital (amounts)					
1	Common Equity Tier 1 (CET1)	208,375.65	209,624.02	203,627.66	194,403.98	188,846.24
1a	Common Equity Tier 1 with transitional arrangements for ECL provisioning not applied					
2	Tier 1	208,375.65	209,624.02	203,627.66	194,403.98	188,846.24
2a	Tier 1 with transitional arrangements for ECL provisioning not applied					
3	Total capital	213,500.47	214,794.12	207,895.02	197,860.40	192,824.79
3a	Total capital with transitional arrangements for ECL provisioning not applied (%)					
	Risk-weighted assets (amounts)					
4	Total risk-weighted assets (RWA)	1,186,355.49	1,231,659.55	1,216,472.42	1,214,042.27	1,199,852.17
4a	Total risk-weighted assets (pre-floor)					
	Risk-based capital ratios as a percentage of RWA					
5	CET1 ratio (%)	17.56%	17.02%	16.74%	16.01%	15.74%
5a	Common Equity Tier 1 ratio with transitional arrangements for ECL provisioning not applied					
5b	CET1 ratio (%) (pre-floor ratio)					
6	Tier 1 ratio (%)	17.56%	17.02%	16.74%	16.01%	15.74%
6a	Tier 1 ratio with transitional arrangements for ECL provisioning not applied (%)					
6b	Tier 1 ratio (%) (pre-floor ratio)					
7	Total capital ratio (%)	18.00%	17.44%	17.09%	16.30%	16.07%
7a	Total capital ratio with transitional arrangements for ECL provisioning not applied (%)					
7b	Total capital ratio (%) (pre-floor ratio)					
	Additional CET1 buffer requirements as a percentage of RWA					
8	Capital conservation buffer requirement (2.5% from 2019) (%)					
9	Countercyclical buffer requirement (%)					
10	Bank G-SIB and/or D-SIB additional requirements (%) **[Not applicable for SMSBs]**					
11	Total of bank CET1 specific buffer requirements (%) (row 8 + row 9 + row 10)					
12	CET1 available after meeting the bank's minimum capital requirements (%)					
	Basel III Leverage ratio					
13	Total Basel III leverage ratio exposure measure	2,272,875.00	2,267,591.00	2,185,310.00	2,138,854.44	2,131,605.21
14	Basel III leverage ratio (row 2 / row 13)	9.17%	9.24%	9.32%	9.09%	8.86%
14a	Basel III leverage ratio (row 2a / row 13) with transitional arrangements for ECL provisioning not applied					

LEVERAGE RATIO

		Q2 2024	Q1 2024
		T	T-1
On-balance sheet exposures			
1	On-balance sheet items (excluding derivatives, SFTs and grandfathered securitization exposures but including collateral)	2,260,064	2,247,488
2	Gross-up for derivatives collateral provided where deducted from balance sheet assets pursuant to the operative accounting framework (IFRS)		
3	(Deductions of receivable assets for cash variation margin provided in derivatives transactions)		
4	(Asset amounts deducted in determining Tier 1 capital)	- 234	- 188
5	**Total on-balance sheet exposures (excluding derivatives and SFTs) (sum of lines 1 to 4)**	2,259,830	2,247,300
Derivative exposures			
6	Replacement cost associated with all derivative transactions	0	0
7	Add-on amounts for potential future exposure associated with all derivative transactions	36	39
8	(Exempted central counterparty-leg of client cleared trade exposures)		
9	Adjusted effective notional amount of written credit derivatives		
10	(Adjusted effective notional offsets and add-on deductions for written credit derivatives)		
11	**Total derivative exposures (sum of lines 6 to 10)**	36	39
Securities financing transaction exposures			
12	Gross SFT assets recognised for accounting purposes (with no recognition of netting), after adjusting for sale accounting transactions		
13	(Netted amounts of cash payables and cash receivables of gross SFT assets)		
14	Counterparty credit risk (CCR) exposure for SFTs		
15	Agent transaction exposures		
16	**Total securities financing transaction exposures (sum of lines 12 to 15)**		
Other off-balance sheet exposures			
17	Off-balance sheet exposure at gross notional amount	32,523	50,629
18	(Adjustments for conversion to credit equivalent amounts)	- 19,514	- 30,377
19	**Off-balance sheet items (sum of lines 17 and 18)**	13,009	20,252
Capital and total exposures			
20	**Tier 1 capital**	208,376	209,624
21	**Total Exposures (sum of lines 5, 11, 16 and 19)**	2,272,875	2,267,591
Leverage ratio			
22	**Basel III leverage ratio**	9.17%	9.24%
Disclosure of mean values			