Financial statements of

# KEB Hana Bank Canada

December 31, 2016

# KEB Hana Bank Canada
## December 31, 2016

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To the Shareholders of KEB Hana Bank Canada

We have audited the accompanying financial statements of KEB Hana Bank Canada, which comprise the statement of financial position as at December 31, 2016, the statements of income and comprehensive income, changes in shareholder's equity and cash flows for the year ended December 31, 2016, and notes, comprising 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.

### *Auditors' 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 our 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, we consider internal control relevant to the Bank's 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 the Bank's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained in our audit 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 KEB Hana Bank Canada as at December 31, 2016, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

KPMG LLP

Chartered Professional Accountants, Licensed Public Accountants

June 23, 2017
Toronto, Canada

# KEB Hana Bank Canada

## Statement of Financial Position

## December 31, 2016, with comparative information for 2015

(In thousands of Canadian dollars)

| | 2016 | 2015 |
|---|---|---|
| | **$** | $ |
| **Assets** | | |
| Cash resources | | |
| Cash | **3,266** | 3,311 |
| Deposits with other banks (Note 6) | **154,060** | 191,806 |
| | **157,326** | 195,117 |
| Securities (Note 7) | **97,906** | 88,967 |
| Loans, net of allowance for credit losses (Notes 8, 9 and 10) | **1,321,534** | 1,320,664 |
| Other | | |
| Property and equipment (Note 11) | **5,138** | 6,109 |
| Intangible asset (Note 12) | **4,498** | 6,036 |
| Other assets (Note 13) | **8,117** | 10,403 |
| Income taxes receivable | **-** | 3,875 |
| Deferred income tax assets (Note 18) | **1,357** | 1,595 |
| | **19,110** | 28,018 |
| | **1,595,876** | 1,632,766 |
| **Liabilities** | | |
| Deposits (Note 14) | | |
| Payable on demand | **229,067** | 164,671 |
| Payable after notice | **170,141** | 150,584 |
| Payable on a fixed date | **953,504** | 1,082,661 |
| | **1,352,712** | 1,397,916 |
| Cheques and other items in transit | **18,286** | 18,064 |
| Other liabilities (Note 15) | **12,759** | 10,989 |
| Income tax payable | **1,169** | - |
| | **32,214** | 29,053 |
| | **1,384,926** | 1,426,969 |
| **Shareholder's equity** | | |
| Share capital (Note 16) | **83,400** | 83,400 |
| Retained earnings | **127,550** | 122,397 |
| | **210,950** | 205,797 |
| | **1,595,876** | 1,632,766 |

On behalf of the Board

_______________ President and Chief Executive Officer

_______________ Chair of the Audit Committee

The accompanying notes are an integral part of these financial statements.

# KEB Hana Bank Canada

## Statement of income and comprehensive income

## Year ended December 31, 2016, with comparative information for 2015

(In thousands of Canadian dollars except net income per share)

| | **2016** | 2015 |
|---|---|---|
| | **$** | $ |
| Interest income | | |
| Loans | **45,396** | 43,443 |
| Deposits with other banks | **937** | 900 |
| Securities | **443** | 304 |
| Other | **52** | 56 |
| Total Interest Income | **46,828** | 44,703 |
| Interest expense | | |
| Deposits | **17,125** | 18,736 |
| Net interest income | **29,703** | 25,967 |
| Non-interest revenue | | |
| Commission revenue | **4,478** | 3,863 |
| Foreign exchange gains, net | **1,861** | 2,222 |
| Other revenue | **23** | 42 |
| | **6,362** | 6,127 |
| Total Revenue | **36,065** | 32,094 |
| Provision for credit losses (recovery) (Note 8, 10 and 15) | **507** | (273) |
| Non-interest expenses | | |
| Salaries | **10,229** | 10,322 |
| Pension contributions and other staff benefits | **2,587** | 2,010 |
| Premises and equipment, including amortization | **6,095** | 5,441 |
| General and administrative expenses | **6,993** | 7,002 |
| Commission expense | **2,479** | 5,151 |
| Other expenses | **15** | 33 |
| | **28,398** | 29,959 |
| Net income before provision for income taxes | **7,160** | 2,408 |
| Income taxes (Note 18) | **2,007** | 518 |
| **Net income and comprehensive income** | **5,153** | 1,890 |

The accompanying notes are an integral part of these financial statements.

# KEB Hana Bank Canada

## Statement of changes in shareholder's equity

## Year ended December 31, 2016, with comparative information for 2015

(In thousands of Canadian dollars)

| | **2016** | 2015 |
|---|---|---|
| | **$** | $ |
| **Share capital:** | | |
| Balance, beginning of period | **83,400** | 33,400 |
| Share capital issued | **-** | 50,000 |
| Balance, end of period | **83,400** | 83,400 |
| **Retained earnings:** | | |
| Balance, beginning of period | **122,397** | 120,507 |
| Net income and comprehensive income | **5,153** | 1,890 |
| Balance, end of period | **127,550** | 122,397 |
| **Total Shareholder's equity** | **210,950** | 205,797 |

The accompanying notes are an integral part of these financial statements.

# KEB Hana Bank Canada

## Statement of cash flows

## Year ended December 31, 2016, with comparative information for 2015

(In thousands of Canadian dollars)

| | **2016** | 2015 |
|---|---|---|
| | **$** | $ |
| **Operating activities** | | |
| Net income | **5,153** | 1,890 |
| Adjustments | | |
| Provision for credit losses | **507** | (273) |
| Deferred income taxes (Note 18) | **234** | 528 |
| Depreciation and amortization (Note 11 and 12) | **2,962** | 2,423 |
| Change in interest receivable and payable, net | **2,801** | 1,435 |
| Unrealized foreign exchange losses | **25** | (1) |
| Foreign exchange translation gains | **(3)** | 39 |
| Change in other items, net | | |
| Change in prepaid expense | **(114)** | 5 |
| Change in prepaid income tax, net of income tax payable | **5,044** | (3,527) |
| Change in other assets, net of other liabilities | **1,259** | 2,306 |
| Loans, net of repayments | **(1,284)** | (39,694) |
| Deposits, net of withdrawals | **(45,205)** | 112,240 |
| Cash flows provided by (used in) operating activities | **(28,621)** | 77,371 |
| **Financing activities** | | |
| Issuance of common shares | **-** | 50,000 |
| Cash flows provided by financing activities | **-** | 50,000 |
| **Investing activities** | | |
| Purchase of securities | **(97,906)** | (88,967) |
| Matured securities | **88,967** | 59,925 |
| Additions of premises and equipment | **(393)** | (4,144) |
| Additions of intangible assets | **(60)** | (4,303) |
| Net change in interest-bearing deposits with other banks | **17,102** | (110,839) |
| Cash flows used in investing activities | **7,710** | (148,328) |
| Decrease in cash and cash equivalents | **(20,911)** | (20,957) |
| Cash and cash equivalents, beginning of year | **37,365** | 58,322 |
| **Cash and cash equivalents, end of year (Note 5)** | **16,454** | 37,365 |
| **Supplemental disclosure of cash flow information** | | |
| Amount of interest received in year | **49,392** | 45,262 |
| Amount of interest paid in year | **16,888** | 17,860 |
| Amount of income taxes paid in year | **(3,270)** | 3,517 |

The accompanying notes are an integral part of these financial statements.

## 1. Reporting entity

KEB Hana Bank Canada (the “Bank”, formerly Korea Exchange Bank of Canada, renamed on November 1, 2015) is a company domiciled in Canada. The bank does not have any subsidiaries. The address of the Bank’s registered office is 4950 Yonge St. Toronto, Ontario, Canada. The Bank is a wholly owned subsidiary of KEB Hana Bank (the "Parent") and is licensed to operate as a bank in Canada with full banking powers under the Bank Act (Canada) as a foreign bank subsidiary. The Bank obtained its letters patent as a Canadian chartered bank and its banking license in 1981. The Bank has grown to 10 branches and 1 sub-branch in Toronto, Vancouver and Calgary offering investment, loan, remittance, export & import, credit card and bill payment services.

## 2. Basis of preparation

*(a) Compliance with International Financial Reporting Standards*

The financial statements of the Bank have been prepared in accordance with International Financial Reporting Standards (IFRS) and IFRS Interpretations Committee (IFRIC) interpretations as issued by the International Accounting Standards Board (IASB). The financial statements also consider IFRS interpretations issued by the Office of the Superintendent of Financial Institutions Canada (OSFI) and are in compliance with Section 308(4) of the Bank Act.

*(b) Functional and presentation currency*

These financial statements are presented in Canadian dollars (CAD), which is the Bank’s functional currency. Except as otherwise indicated, financial information presented in CAD has been rounded to nearest thousand.

In preparing the financial statements of the Bank, transactions in currencies other than the Bank’s functional currency (foreign currencies) are recognized at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are translated at the rates prevailing at the statement of financial position date. Non-monetary items carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured at historic cost are translated at the historic exchange rate.

*(c) Use of estimates and assumptions*

The preparation of the financial statements requires management to make estimates and judgment that affect the application of accounting policies and the reported amount of assets and liabilities and disclosure of contingencies at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. The use of available information and the application of judgment are inherent in the formation of estimates. Actual results in the future may differ from estimates upon which financial information is prepared. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

Management determined that the Bank’s critical accounting policies where judgment and estimates are applied are those which relate to impairment of loans and advances, the valuation of financial instruments, and the valuation of deferred taxes. Further information about key assumptions concerning the future, and other key sources of estimation uncertainty, are set out in the notes to financial statements.

Information about significant areas of estimation uncertainty and critical judgments relating to allowance for credit losses on loans are disclosed in Note 10.

**3. Significant accounting policies**

The significant accounting policies used in the preparation of these financial statements are summarized below. Other than information in the statement of cash flows, the accrual basis is used to prepare the financial statements.

*(a) Revenue recognition*

1) Interest income and interest expense

Interest income (expense) is recognized on an effective interest basis. The effective interest method is a method of calculating the amortized cost of a financial instrument and of allocating interest income or interest expense over the relevant period.

2) Commission revenue

Commission revenues are classified and accounted as follows:

| Classification | Details |
|---|---|
| Loan origination fee | Accounted for as an adjustment to the effective interest rate |
| Commission for rendering services | Revenue is recognized when the services are provided |
| Commission for performing significant activities | Revenue is recognized when the significant activities have been completed |

*(b) Financial instruments*

The Bank's classification of financial assets and financial liabilities are as follows:

| | |
|---|---|
| Loans | Loans and receivables |
| Securities | Held to maturity |
| Accrued interest receivable and other receivables | Loans and receivables |
| Deposits | Other financial liabilities |
| Cheques and other items in transit | Other financial liabilities |
| Accrued interest payable and accrued liabilities | Other financial liabilities |

*(c) Cash and cash equivalents*

Cash and cash equivalents consist of cash and deposits with other banks (with an original term to maturity of 90 days or less) less cheques and other items in transit. Cash and cash equivalents are carried at amortized cost in the statement of financial position

*(d) Deposits with other banks*

Deposits with regulated financial institutions are recorded at amortized cost. Interest income on interest bearing deposits is recorded using effective interest method.

*(e) Cheques and other items in transit, net*

Cheques and other items in transit representing uncleared settlements with other banks are recorded at cost.

*(f) Securities*

Securities are held to maturity investments that have fixed or determinable payments and a fixed maturity that the bank has the positive intention and ability to hold to maturity.

### 3. Significant accounting policies (continued)

*(g) Loans and receivables*

Loans, accrued interest receivable and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as 'loans and receivables'.

Loans and receivables are measured at amortized cost using the effective interest method, less any impairment. Interest income is recognized by applying the effective interest rate, except for short-term receivables when the recognition of interest would be insignificant.

1) Deferred loan origination fees and costs

The Bank defers loan origination fees and costs associated with originating loans and loan origination costs that have future economic benefits. Loan balances are reported net of these loan origination fees and costs. The deferred loan origination fees and costs are amortized using the effective interest method with the amortization recognized as adjustments to other interest income.

2) Allowance for credit losses

The Bank maintains an allowance for credit losses, which in management's opinion is considered adequate to absorb all credit-related losses in its portfolio of both on-and off-statement of financial position items, including deposits with regulated financial institutions, loan substitute securities, loans, acceptances, derivative instruments and other credit-related contingent liabilities, such as letters of credit and guarantees.

The allowance for credit losses consists of a Collective Allowance and Individual Allowances, each of which is reviewed on a regular basis. The balance in the allowance for credit losses account is deducted from the related asset category, except for provisions against acceptances and off-statement of financial position items, if any, which are included in other liabilities.

Individual Allowances are determined on an item-by-item basis and reflect the associated estimated credit loss. The Collective Allowance is established to absorb probable credit losses on the aggregate exposures in each of the Bank's business lines, for which losses are not yet specifically identified on an item-by-item basis. The Collective Allowance is based upon the credit rating determined using statistical analysis of past performance, current economic considerations, the level of allowance already in place and management's judgment.

The amount of the provision for credit losses that is charged to the statement of income and comprehensive income is the actual net credit loss experience for the year. It is the amount that is required to establish a balance in the allowance for credit losses account that management considers adequate to absorb all credit-related losses in its portfolio for on- and off-statement of financial position items, after charging amounts written off during the year, net of recoveries, to the allowance for credit losses account.

An immaterial adjustment of $5,377 has been recorded to increase the collective allowance from $4,512 to $9,889 at the beginning of 2015 to reflect an adjustment to an input used in determining the collective allowance. The related tax impact to increase income tax assets of $1,418 has also been recorded.

3) Impairment of financial assets

Financial assets, other than those classified as held for trading, are assessed for indicators of impairment at the end of each reporting period. Financial assets are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the asset have been affected. However, impairment losses expected as a result of future events are not recognized.

Objective evidence that a financial asset is impaired includes the following:

- significant financial difficulty of the issuer or obligor; or

**3. Significant accounting policies (continued)**

- a breach of contract, such as a default or delinquency in interest or principal payments; or

*(g) Loans and receivables (continued)*

3) Impairment of financial assets (continued)

- the lender, for economic or legal reasons relating to borrowers' financial difficulty, granting to the borrower a concession that the lender would not otherwise consider; or
- it becoming probable that the borrower will enter bankruptcy or other financial reorganization;
- the disappearance of an active market for the financial asset because of financial difficulties; or
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group

Impairment loss is measured as the difference between the asset's carrying amount and the present value of expected future cash flows discounted at the financial asset's original effective interest rate. All individually significant loans are assessed for objective evidence of individual impairment.

For financial assets that are not individually significant, the Bank assesses whether the objective evidence of impairment exists individually or collectively. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment.

A loan is classified as impaired when, in management's opinion, there has been deterioration in credit quality to the extent that there is no longer reasonable assurance as to the timely collection of the full amount of principal and interest. Loans where interest or principal is contractually past due 90 days are automatically recognized as impaired, unless management determines that the loan is fully secured, in the process of collection and the collection efforts are reasonably expected to result in either repayment of the loan or restoring it to a current status within 180 days from the date the payment has become contractually in arrears. All loans are classified as impaired when interest or principal is past due 180 days. When a loan is classified as impaired, interest continues to be recognized at the effective rate based on the revised expected future cash flows of the impaired loan.

Impairment losses are deducted from the allowance for credit losses when the impairment is considered unrecoverable. If in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed by adjusting the allowance account. The reversal does not result in a carrying amount of the loan that exceeds what the amortized cost would have been had the impairment not been recognized at the date the impairment is reversed. The amount of the reversal is being recognized in the statement of comprehensive income.

a) Allowance for credit losses on individual loans by individual assessment

Allowance for credit losses on loans are recognized as the difference between the asset's carrying amount and the present value of future cash flows expected to be collected by considering borrower's repayment performance, financial position, overdue period, collateral, and mortgage amount. Individual Allowances for the loans are determined on an item-by-item basis and reflect the associated estimated credit loss. The individual allowance is the amount that is required to reduce the carrying value of an impaired loan to its estimated realizable amount. Generally, the estimate realizable amount is determined by discounting the expected future cash flows at the original interest rate inherent in the loan at the date of impairment. When the amounts and timing of future cash flows cannot be measured with reasonable reliability, either the fair value of any collateral underlying the loan, net of expected costs of realization and any amounts legally required to be paid to the borrower, or the observable market price for the loan is used to measure the estimated realizable amount. Individual allowances

**3. Significant accounting policies (continued)**

*(g) Loans and receivables (continued)*

3) Impairment of financial assets (continued)

a) Allowance for credit losses on individual loans by individual assessment

Allowance for credit losses on loans are recognized as the difference between the asset's carrying amount and the present value of future cash flows expected to be collected by considering borrower's repayment performance, financial position, overdue period, collateral, and mortgage amount. Individual Allowances for the loans are determined on an item-by-item basis and reflect the associated estimated credit loss. The individual allowance is the amount that is required to reduce the carrying value of an impaired loan to its estimated realizable amount. Generally, the estimate realizable amount is determined by discounting the expected future cash flows at the original interest rate inherent in the loan at the date of impairment. When the amounts and timing of future cash flows cannot be measured with reasonable reliability, either the fair value of any collateral underlying the loan, net of expected costs of realization and any amounts legally required to be paid to the borrower, or the observable market price for the loan is used to measure the estimated realizable amount. Individual allowances for residential mortgages and most personal loans are calculated using a formula method taking into account recent loss experience.

b) Allowance for credit losses on loans by collective assessment

The allowance for credit losses on collective assessments are recognized by adjusting Probability of Default (PD) and Loss Given Default (LGD) from Basel II for the purpose of accounting and applying that to carrying amount of the loan portfolio. This approach considers various elements including borrower type, credit rating, and size of portfolio, Loss Emergence Period (LEP), and collection period and applies consistent assumptions so as to model the measurement of inbuilt loss and determine variables based on historical loss experience and current conditions.

The collective allowance is established against the loan portfolio in respect of the Bank's core business lines where prudent assessment by the Bank of past experience and existing economic and portfolio conditions indicate that it is probable that losses have occurred, but where such losses cannot be determined on an item-by-item basis. The collective allowance for the loans to corporate is underpinned by a risk rating process in which internal risk ratings are assigned at the time of loan origination, monitored on an ongoing basis, and adjusted to reflect changes in underlying credit risk and for the loans to household is assessed based on pool. Based upon recent observable data, senior management forms a judgment whether adjustments are necessary to the initially calculated (quantitative) allowance and the amount of any such adjustments. In making this judgment, management considers observable factors such as economic trends and business conditions, portfolio concentrations, and trends in volumes and severity of delinquencies. The level of the collective allowance is re-assessed on regular basis and may fluctuate as a result of changes in portfolio volumes, concentrations and risk profile; analysis of evolving trends in probability of loss, severity of loss and exposure at default factors; and management's current assessment of factors that may have affected the condition of the portfolio. While the total collective allowance is established through a step-by-step process that considers risk arising from specific segments of the portfolio, the resulting total Collective allowance is available to absorb all incurred losses in the loan portfolio for which there has been no individual allowance. The collective allowance for credit losses is recorded as a reduction of loans in the statement of financial position.

4) Derecognition of financial assets

The Bank derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity.

**3. Significant accounting policies (continued)**

*(g) Loans and receivables (continued)*

5) Offsetting of financial assets and liabilities

Financial assets and liabilities are offset only when the Bank has the legal right to offset assets and liabilities and intends either to settle on a net basis, or to realize the asset and settle the liability simultaneously.

*(h) Property and equipment*

Furniture and equipment and leasehold improvements are carried at cost less accumulated depreciation/amortization.

Furniture and equipment are depreciated using the straight-line method over their estimated useful lives of 4 years. Leasehold improvements are amortized over the 10 years using the straight-line method.

Gains and losses on disposal of equipment are recorded in the statement of comprehensive income in the year of disposal.

*(i) Intangible asset*

The intangible asset represents computer software that is not an integral part of the related hardware and is reported at cost less accumulated amortization on a straight-line basis over 5 years.

Gains and losses on disposal of computer software are recorded in the statement of comprehensive income in the year of disposal.

*(j) Income taxes*

Income tax expense comprises current and deferred taxes. Current tax and deferred tax are recognized in income except to the extent that it relates to items recognized directly in OCI or equity. Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to taxes payable in respect of previous years.

The Bank follows the asset and liability method of accounting for income taxes. Under the asset and liability method, deferred tax assets and liabilities are recognized for the deferred tax consequences attributable to differences between the financial statement carrying amounts of the assets and liabilities and their values for tax purposes. Deferred tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income, except to the extent that it relates to items recognized directly in OCI or equity, in the period that includes the date of enactment or substantive enactment.

Current tax assets and liabilities are offset if there is a legally enforceable right to offset current tax assets against current tax liabilities, usually in respect of income taxes levied by the same tax authority on the same taxable entity, and the Bank intends to settle current tax liabilities and assets on a net basis or settle the tax assets and liabilities simultaneously.

Deferred tax assets and liabilities are offset if the Bank has a legally enforceable right to set off the deferred tax assets and liabilities related to income taxes levied by the same tax authority on either the same taxable entity; or different taxable entities, but the entities intend to settle current tax liabilities and assets on a net basis, or their tax assets and liabilities will be realized simultaneously for each future period in which these differences reverse.

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent it is no longer probable that the related tax benefit will be realized.

### 4. Future changes in accounting standards

Certain new accounting standards and interpretations have been published that are not yet effective for the year ended December 31, 2016 and have not been early adopted by the Bank in preparing these financial statements. The Bank's assessment of the impact of these new standards and interpretations is set out below.

*(a) IFRS 9, Financial Instruments ("IFRS 9")*

IFRS 9 addresses the classification, measurement and derecognition of financial assets and financial liabilities and introduces new rules for hedge accounting. In July 2014, the IASB made further changes to the classification and measurement rules and also introduced a new impairment model. These latest amendments now complete the new financial instruments standard. The standard must be applied for financial years commencing on or after January 1, 2018. Based on the transitional provisions in the completed IFRS 9, early adoption in phases was only permitted for annual reporting periods beginning before February 1, 2015. After that date, the new rules must be adopted in their entirety. The Bank is evaluating the impact of the adoption of IFRS 9

*(b) IFRS 15, Revenue from Contracts with Customers ("IFRS 15")*

IFRS 15 will replace IAS 18, which covers contracts for goods and services and IAS 11 which covers construction contracts. The new standard is based on the principle that revenue is recognized when control of a good or service transfers to a customer - so the notion of control replaces the existing notion of risks and rewards. The standard permits a modified retrospective approach for the adoption. Under this approach entities will recognize transitional adjustments in retained earnings on the date of initial application without restating the comparative period. They will only need to apply the new rules to contracts that are not completed as of the date of initial application. The standard is mandatory for financial years commencing on or after January 1, 2018. The Bank is evaluating the impact of the adoption of IFRS 15

*(c) IFRS 16, Leases ("IFRS 16")*

IFRS 16 will replace IAS 17 which covers accounting for leases. The new model requires the lessee to recognize almost all lease contracts on the statements of financial position as a lease liability reflecting future lease payments and a right-of-use asset; the only optional exemptions are for certain short-term leases and leases of low-value assets. The new guidance will also require the part of the lease payments that reflects interest on the lease liability to be presented as an operating cash flow (depending on the entity's accounting policy regarding interest payments) and cash payments for the principal portion of the lease liability to be presented within financing activities. The standard applies to annual periods beginning on or after January 1, 2019, with earlier application permitted if IFRS 15 is also applied. The Bank is evaluating the impact of the adoption

(In thousands of Canadian dollars, except otherwise noted)

### 5. Cash and cash equivalents

Cash and cash equivalents composition is as follows:

| | **December 31, 2016** | December 31, 2015 |
|---|---|---|
| | **$** | $ |
| Cash | **3,266** | 3,311 |
| Non-interest bearing deposits with other banks | **31,474** | 52,118 |
| Cheques and other items in transit, net | **(18,286)** | (18,064) |
| | **16,454** | 37,365 |

### 6. Deposits with other banks

| | **December 31, 2016** | December 31, 2015 |
|---|---|---|
| | **$** | $ |
| Non-interest bearing deposits | **31,474** | 52,118 |
| Interest-bearing deposits | **122,586** | 139,688 |
| | **154,060** | 191,806 |

Average effective yield for interest bearing deposits based on book values and contractual interest rates are 0.76% (2015 – 0.85%).

Deposits with other banks include $58,976 (2015 - $60,808) denominated in foreign currencies.

### 7. Securities

| | | **2016** | | 2015 |
|---|---|---|---|---|
| | **Fair value** | **Carrying** | Fair value | Carrying |
| | | **$** | | $ |
| Held to maturity | | | | |
| Issued by: | | | | |
| Canadian provincial governments | **87,913** | **87,913** | 88,956 | 88,967 |
| Schedule 1 Financial Institution | **9,993** | **9,993** | - | - |
| | **97,906** | **97,906** | 88,956 | 88,967 |

Securities consist of held to maturity bonds that are issued by Government of Quebec, Province of British Columbia, Province of Ontario, Province of New Brunswick, Province of Nova Scotia and Bank of Montreal. They are carried at amortized cost using the effective interest method. The fair value of these securities approximate their carrying value given their short term nature.

(In thousands of Canadian dollars, except otherwise noted)

### 8. Loans

| | **December 31, 2016** | December 31, 2015 |
|---|---|---|
| | **$** | $ |
| Individual loans | **139,544** | 141,050 |
| Business loans | **167,593** | 171,259 |
| Residential mortgages | **596,219** | 562,357 |
| Commercial mortgages | **425,407** | 454,823 |
| Other | **2,264** | 678 |
| Allowance for credit losses | **(10,310)** | (10,094) |
| Deferred loan fees | **817** | 591 |
| | **1,321,534** | 1,320,664 |

Total net loans include loans of $42,583 (2015 - $43,379) denominated in a foreign currency (USD). Included in $139,522 of individual loans, is $59,182 (2015 - $56,786) of immigrant investor loans, which are collateralized by the assignment of promissory notes from the Government of Canada.

### 9. Impaired loans

| | **December 31, 2016** | | | December 31, 2015 | | |
|---|---|---|---|---|---|---|
| | **Gross impaired loans** | **Individual allowance** | **Carrying amount** | Gross impaired loans | Individual allowance | Carrying amount |
| | **$** | **$** | **$** | $ | $ | $ |
| Loans | **2,264** | **421** | **1,843** | 678 | 206 | 472 |

An analysis of the age of financial assets that are past due as at the end of the year but not impaired is as follows:

| | **December 31, 2016** | | December 31, 2015 | |
|---|---|---|---|---|
| | **Amount** | **Ratio** | Amount | Ratio |
| Total loans* | **1,331,027** | | 1,330,167 | |
| Overdue loans, including impaired loans | **3,427** | **0.26%** | 1,480 | 0.11% |
| Overdue loans, but not impaired | **1,163** | **0.09%** | 802 | 0.06% |
| Less than 31 days | **40** | **0.00%** | 296 | 0.02% |
| 31 to 89 days | **630** | **0.05%** | 506 | 0.04% |
| 90 days and older | **492** | **0.04%** | - | 0.00% |
| Impaired loans** | **2,264** | **0.17%** | 678 | 0.05% |

* Total loans: Net loans - allowance for credit losses - deferred loan fees (refer to Note 8)

** Impaired loans are both overdue and impaired

Total net interest income from impaired loans is $8 (2015 - $191).

(In thousands of Canadian dollars, except otherwise noted)

### 10. Allowance for credit losses on loans

| | **December 31, 2016** | | | December 31, 2015 | | |
|---|---|---|---|---|---|---|
| | **Individual allowances** | **Collective allowances** | **Total** | Individual allowances | Collective allowances | Total |
| | **$** | **$** | **$** | $ | $ | $ |
| Balance, beginning of year | **205** | **9,888** | **10,093** | 521 | 9,889 | 10,410 |
| Provision for credit losses (recovery) | **394** | **3** | **397** | (194) | 40 | (154) |
| Write-off of credit losses | **(148)** | **(2)** | **(150)** | (107) | (56) | (163) |
| Unwinding effects* | **(30)** | **-** | **(30)** | (15) | - | (15) |
| Foreign currency translation gain/loss | **-** | **-** | **-** | - | 15 | 15 |
| Balance, end of year | **421** | **9,889** | **10,310** | 205 | 9,888 | 10,093 |

*When the allowance is calculated, it is based on present value of future cash flows. Unwinding effects refer to the change in the present value attributable to the passage of time on the expected future cash flows and is reported as a reduction of the provision for credit losses in the Statement of Comprehensive Income.

An immaterial adjustment of $5,377 has been recorded to increase the collective allowance from $4,512 to $9,889 at the beginning of 2015 to reflect an adjustment to an input used in determining the collective allowance. The related tax impact to increase income tax assets of $1,418 has also been recorded.

### 11. Property and equipment

Property and equipment comprise the following:

| | | | **2016** | 2015 |
|---|---|---|---|---|
| | **Furniture and fixtures** | **Leasehold improvements** | **Total** | Total |
| | **$** | **$** | **$** | $ |
| Cost | | | | |
| At January 1 | **5,922** | **7,995** | **13,917** | 9,959 |
| Additions | **344** | **49** | **393** | 4,144 |
| Disposals | **(57)** | **-** | **(57)** | (186) |
| At December 31 | **6,209** | **8,044** | **14,253** | 13,917 |
| Accumulated depreciation | | | | |
| At January 1 | **(3,714)** | **(4,094)** | **(7,808)** | (6,822) |
| Depreciation expense for the year | **(777)** | **(587)** | **(1,364)** | (1,172) |
| Decrease due to disposals | **57** | **-** | **57** | 186 |
| At December 31 | **(4,434)** | **(4,681)** | **(9,115)** | (7,808) |
| Net book value at December 31 | **1,775** | **3,363** | **5,138** | 6,109 |

(In thousands of Canadian dollars, except otherwise noted)

### 12. Intangible asset

The Bank has capitalized software development costs as follows:

| | **2016** | 2015 |
|---|---|---|
| | **Total** | Total |
| | **$** | $ |
| Cost | | |
| At January 1 | **8,310** | 4,007 |
| Additions | **60** | 4,303 |
| Disposals | **-** | - |
| At December 31 | **8,371** | 8,310 |
| Accumulated amortization | | |
| At January 1 | **(2,274)** | (1,023) |
| Amortization expense for the year | **(1,598)** | (1,251) |
| At December 31 | **(3,872)** | (2,274) |
| Net book value at December 31 | **4,498** | 6,036 |

### 13. Other assets

| | **December 31, 2016** | December 31, 2015 |
|---|---|---|
| Interest receivable | **3,731** | 6,295 |
| Prepaid expenses | **984** | 870 |
| Other | **3,402** | 3,238 |
| | **8,117** | 10,403 |

### 14. Deposit Liabilities

| | | | | **December 31, 2016** | December 31, 2015 |
|---|---|---|---|---|---|
| | **Payable on demand** | **Payable after notice** | **Payable on a fixed date** | **Total** | Total |
| | **$** | **$** | **$** | | |
| Other banks | **11,488** | **-** | **-** | **11,488** | 6,491 |
| Individuals | **46,529** | **125,516** | **563,095** | **735,140** | 678,712 |
| Other | **171,050** | **44,625** | **390,409** | **606,084** | 712,713 |
| | **229,067** | **170,141** | **953,504** | **1,352,712** | 1,397,916 |

Total deposits include $136,906 (Dec 31, 2015 - $157,908) denominated in foreign currencies (USD and South Korean Won (KRW)).

(In thousands of Canadian dollars, except otherwise noted)

### 15. Other liabilities

| | **December 31, 2016** | December 31, 2015 |
|---|---|---|
| | **$** | $ |
| Interest payable | **10,340** | 10,103 |
| Reserve for impairment (guarantees) | **54** | 24 |
| Reserve for unused commitment | **124** | 45 |
| Other | **2,241** | 817 |
| | **12,759** | 10,989 |

Provision for impairment (guarantees) for 2016 is $30 (2015 – ($9)).

Provision for unused commitment for 2016 is $79 (2015 – ($91)).

### 16. Share capital

| | **2016** | | 2015 | |
|---|---|---|---|---|
| | **Shares** | **Amount** | Shares | Amount |
| | | **$** | | $ |
| *Authorized* | | | | |
| Unlimited common shares | | | | |
| *Issued and fully paid* | | | | |
| Common shares, beginning of year | **834,000** | **83,400** | 334,000 | 33,400 |
| Issuance of common shares | **-** | **-** | 500,000 | 50,000 |
| Common shares, end of year | **834,000** | **83,400** | 834,000 | 83,400 |

Par value per share is $100 per share. 100% of outstanding shares are owned by parent and no preferred stock exists. No dividends were paid during the years ended December 31, 2016 and 2015.

### 17. Fair values of financial instruments

The amounts set out in the table below represent the fair values of the Bank’s financial instruments using the valuation methods and assumptions described below.

The estimated fair value amounts are designed to approximate amounts at which instruments could be exchanged in a current transaction between willing parties who are under no compulsion to act. However, some of the Bank’s financial instruments lack an available trading market. Therefore, fair values are based on estimates using present value and other valuation techniques, which are significantly affected by the assumptions used concerning the amount and timing of estimated future cash flows and discount rates, which reflect varying degrees of risk. Because of the estimation process and the need to use judgment, the aggregate fair value amounts should not be interpreted as being necessarily realizable in an immediate settlement of the instruments.

(In thousands of Canadian dollars, except otherwise noted)

### 17. Fair values of financial instruments (continued)

| | | | **December 31, 2016** |
|---|---|---|---|
| | **Book value** | **Fair value** | **Fair value over (under) book value** |
| | **$** | **$** | **$** |
| Statement of financial position | | | |
| Assets | | | |
| Cash | **3,266** | **3,266** | **-** |
| Deposits with other banks | **154,061** | **154,061** | **-** |
| Securities | **97,906** | **97,906** | **-** |
| Loans, net of allowance for credit losses | **1,321,534** | **1,320,934** | **(600)** |
| Interest receivable | **3,731** | **3,731** | **-** |
| Liabilities | | | |
| Deposits | **1,352,712** | **1,354,628** | **1,916** |
| Cheques and other items in transit | **18,286** | **18,286** | **-** |
| Interest payable | **10,340** | **10,340** | **-** |

| | | | December 31, 2015 |
|---|---|---|---|
| | Book value | Fair value | Fair value over (under) book value |
| | $ | $ | $ |
| Statement of financial position | | | |
| Assets | | | |
| Cash | 3,311 | 3,311 | - |
| Deposits with other banks | 191,806 | 191,806 | - |
| Securities | 88,967 | 88,956 | (11) |
| Loans, net of allowance for credit losses | 1,320,664 | 1,320,373 | (291) |
| Interest receivable | 6,295 | 6,295 | - |
| Liabilities | | | |
| Deposits | 1,397,916 | 1,399,693 | 1,777 |
| Cheques and other items in transit | 18,064 | 18,064 | - |
| Interest payable | 10,103 | 10,103 | - |

The following methods and assumptions were used to estimate the fair values of financial instruments:

Management considers that due to their short-term nature, the carrying values of certain financial instruments are assumed to approximate their fair values. These financial instruments include cash, deposits with other banks, securities, interest receivable, cheques and other items in transit and interest payable.

(In thousands of Canadian dollars, except otherwise noted)

### 17. Fair values of financial instruments (continued)

Management considers that the estimated fair value of loans reflects changes in credit risk and general interest rates that have occurred since the loans were originated. The particular valuation methods used are as follows:

(a) For floating rate loans, fair value is assumed to be equal to book values as the interest rates on these loans automatically reprice to market.
(b) For fixed rate loans that mature within one year are assumed to be equal to their book values due to their short-term nature.
(c) For all other loans, fair value is determined by discounting the expected future cash flows of the loans at market rates for loans with similar terms and credit risks.

The fair values of deposits payable on demand, payable after notice and fixed date deposit payable on a fixed date that mature within one year, are assumed to be equal to their carrying values. The estimated fair values of fixed rate deposits payable on a fixed date over one year are determined by discounting the contractual cash flow using market interest rates currently offered for deposits with similar terms and risks.

### 18. Income taxes

Income tax expense for the year consists of the following:

| | **2016** | 2015 |
|---|---|---|
| | **$** | $ |
| *Current* | | |
| Current year tax expense | **2,062** | 648 |
| Adjustment for prior year | **(289)** | (658) |
| | **1,773** | (10) |
| *Deferred* | | |
| Origination/reversal of temporary differences | **234** | 528 |
| | **234** | 528 |
| Total income tax expense | **2,007** | 518 |

(In thousands of Canadian dollars, except otherwise noted)

**18. Income taxes (continued)**

The provision for income taxes differs from the income taxes that would be payable by applying the combined Canadian federal and provincial statutory income tax rate to the effective income tax rate. This difference results from the following:

| | **$** | $ |
|---|---|---|
| Income before income taxes | **7,160** | 2,408 |
| Combined federal and provincial income tax rate | **26.41%** | 26.37% |
| Income taxes at the statutory income tax rate | **1,891** | 635 |
| Non-deductible items | **45** | 57 |
| Prior year adjustment and other | **71** | (174) |
| Income tax expense | **2,007** | 518 |

| | | |
|---|---|---|
| Comprised of : | | |
| Current income taxes | **1,773** | (10) |
| Deferred income taxes | **234** | 528 |
| Income tax expense | **2,007** | 518 |

Deferred tax assets (liabilities) arise from the following:

| **December 31, 2016** | **Opening balance** | **Recognized in profit & loss** | **Acquisition/ disposition** | **Closing balance** |
|---|---|---|---|---|
| Property and equipment | **(997)** | **(100)** | **-** | **(1,097)** |
| Allowance reserve for credit losses | | | | |
| Collective (general) allowances | **2,636** | **22** | **-** | **2,658** |
| Individual (specific) allowances | **6** | **6** | **-** | **12** |
| Others | **(50)** | **(166)** | - | **(216)** |
| Deferred tax assets (liabilities) | **1,595** | **(238)** | **-** | **1,357** |

| December 31, 2015 | Opening balance | Recognized in profit & loss | Acquisition/ disposition | Closing balance |
|---|---|---|---|---|
| Property and equipment | (507) | (490) | - | (997) |
| Allowance reserve for credit losses | - | | | |
| Collective (general) allowances | 2,662 | (26) | - | 2,636 |
| Individual (specific) allowances | 14 | (8) | - | 6 |
| Others | (49) | (1) | - | (50) |
| Deferred tax assets (liabilities) | 2,120 | (525) | - | 1,595 |

Management has determined there is an expectation of sufficient future taxable income to support the recoverability of the deferred tax assets.

(In thousands of Canadian dollars, except otherwise noted)

### 19. Pension plan

The Bank has a defined contribution plan that provides post-retirement benefits to the majority of its employees. The pension plan is funded by contributions from the Bank. Contributions to the plan are expensed in the year that they are made. Total cash contributions made to the contribution plan by the Bank for 2016 were $317 (2015 - $276).

### 20. Lease commitments

The Bank has obligations under long-term, non-cancellable operating leases for office premises. The future minimum annual lease payments for the remainder of the lease terms are as follows:

| | $ |
|---|---|
| 2017 | 1,589 |
| 2018 | 1,579 |
| 2019 | 1,603 |
| 2020 | 1,437 |
| 2021 and thereafter | 3,717 |
| | 9,925 |

The total rental expense charged in respect of office premises for the year ended December 31, 2016 was $2,622 (2015 - $2,492).

### 21. Guarantees and letters of credit

Summarized below are the guarantees issued and outstanding as at December 31:

| | **2016** | 2015 |
|---|---|---|
| | **Maximum potential amount of future payments** | Maximum potential amount of future payments |
| Guarantees | **37,093** | 39,296 |
| Letters of credit | **14** | 97 |
| | **37,107** | 39,393 |

Guarantees and letters of credit are considered contingent liabilities and thus not recognized on the statement of financial position.

Performance guarantees are transaction-related contingencies and represent irrevocable assurances that the Bank will make payments in the event that a customer cannot meet its performance obligations to third parties. The term of these guarantees can range up to 1 year. The Bank’s policy for requiring collateral security with respect to these instruments and the types of collateral security held is generally the same as for loans.

Financial letters of credit are direct credit substitutes and represent irrevocable assurances that the Bank will make payments in the event that a customer cannot meet its financial obligations to third parties. The term of these guarantees can range up to 1 year.

(In thousands of Canadian dollars, except otherwise noted)

### 21. Guarantees and letters of credit (continued)

As many of these guarantees will expire or terminate without being drawn upon and do not take into consideration the possibility of recovery by means of recourse provisions or from collateral held or pledged, the contractual amounts are not indicative of future cash requirements or credit risk, and may not bear any relationship to the Bank's expected losses from these arrangements. In the event of a call on these commitments, the Bank has recourse against the customers.

### 22. Related party transactions

In the normal course of business, the Bank enters into transactions with its Parent and companies under common control on terms similar to those offered to non-related parties. These transactions are recorded at fair value. Significant balances and transactions with related parties are as follows:

| | **2016** | 2015 |
|---|---|---|
| | **$** | $ |
| Deposits with other banks | **1,029** | 1,031 |
| Deposits payable on demand | **9,910** | 2,586 |
| Management fee | **340** | 2,388 |
| 1Q banking development and maintenance fee | **579** | 2,630 |
| IT service fee | **1,921** | 1,694 |
| Commission expense | **16** | 31 |
| Interest income - deposits with other banks | **9** | 16 |
| Interest expense - deposits | **425** | 195 |
| Foreign exchange income | **13** | 12 |

### 23. Directors and other key management personnel

Key management personnel are defined as those persons having authority and responsibility for planning, directing and controlling the activities of the Bank, being senior executives and members of the Board of Directors.

Directors that simultaneously are under an employment contract with the Bank or its affiliates do not receive additional remuneration for the services rendered as a director. In contrast, external directors that are not employees of the Bank are entitled to receive pre-determined annual remuneration.

Remuneration for executives, directors, and expatriate senior executives are determined in accordance with respective employment contracts and/or the remuneration policy of the Parent Bank. Notwithstanding, compensation for local executives are determined in accordance with the terms and conditions of the 'Procedures for Remuneration' as approved by the Board of Directors.

Compensation for external directors and senior executives including CEO are as follows:

| | **2016** | 2015 |
|---|---|---|
| Number of directors and senior executives | **13** | 17 |
| Directors | **5** | 6 |
| Senior executives | **8** | 11 |
| | | |
| Salaries and short-term employee benefits | **$1,683** | $2,691 |
| Directors | **59** | $51 |
| Senior executives | **1,624** | $2,640 |

(In thousands of Canadian dollars, except otherwise noted)

## 23. Directors and other key management personnel (Continued)

Salaries and short-term employee benefits contain the amount contributed toward defined contribution plan of $25 (2015 - $21).Post-employment benefits, other long-term benefits, termination benefits and share-based payments are not applicable in 2015 and 2016.

## 24. Capital management

*Regulatory capital and capital ratios*

As outlined in the Basel III framework, the Bank's capital structure is separated into Common Equity Tier 1 (CET1) capital, Additional Tier 1 capital, and Tier 2 capital. The Bank, however, does not have Additional Tier 1 capital or Tier 2 capital. Therefore, Total Capital only consists of Tier 1 capital among which includes common shareholders' equity and retained earnings as well as regulatory adjustments for goodwill and other intangible assets. The difference between all-in base capital and transitional base capital comes from how much of such deductions are taken into account for adjustments. In 2016, a 60% weight is applied to the deductions, thus retaining 40% of intangible assets.

The Bank measures capital ratios on both bases and leverage ratios. To calculate capital ratios, Total Capital is divided by Total Risk-Weighted Assets (RWA) of both credit risk exposures and operational risk exposures. Leverage ratio is measured by dividing all-in base Tier 1 capital by Total Exposure, which consists of on-balance sheet exposures, off-balance sheet exposures, derivative exposures, and security financing transactions. Regulatory capital ratios are measured every month and reported quarterly to Risk Management Committee of the Board and to OSFI. As of December 31, 2016, the Bank has complied with the regulatory CET1 ratio of 7%, Tier 1 ratio of 8.5%, Total Capital ratio of 10.5%, Internal Target Capital Ratio of 14.3%, and the regulatory requirement of leverage ratio of 12.0%.

| | **All-in (1)** | **Transitional (2)** | All-in |
|---|---|---|---|
| | **December 31, 2016** | **December 31, 2016** | December 31, 2015 |
| | **$** | **$** | $ |
| Common shares | **83,400** | **83,400** | 83,400 |
| Retained earnings | **127,550** | **127,550** | 122,397 |
| *Total regulatory adjustments* | **(4,498)** | **(2,699)** | (6,036) |
| Total Tier 1 Capital | **206,452** | **208,251** | 199,761 |
| Total Capital | **206,452** | **208,251** | 199,761 |
| Risk-weighted assets | **944,775** | **946,572** | 967,660 |
| | **%** | **%** | % |
| Tier 1 Capital Ratio | **21.85** | **22.00** | 20.64 |
| Total Capital Ratio | **21.85** | **22.00** | 20.64 |
| Leverage Ratio | **12.58** | | 11.93 |

(1) The all-in methodology includes all regulatory adjustments that will be required by 2019, while retaining the phase-out rules for non-qualifying capital instruments as per OSFI Guidelines.
(2) The transitional methodology is defined as capital calculated according to the current year's phase-in of regulatory adjustment and phase-out of non-qualifying capital instruments.

(In thousands of Canadian dollars, except otherwise noted)

**25. Financial instruments and risk management**

The Bank is exposed to market risk (consisting of interest rate and currency risk), liquidity risk, and credit risk. Parent Bank and Risk Management Committee have overall responsibility for the establishment of oversight of the Bank's risk management framework. Securitization and equity risk are not applicable to the Bank due to no exposure for trading purpose.

*Interest rate risk ("IRR")*

Interest rate risk arising from the Bank's lending, funding and investment activities is managed in accordance with Board-approved policies and global limits, which are designed to control the risk to net interest income and economic value of shareholders' equity.

The Bank's objective is to minimize the interest rate risk. For the IRR measurement, two key measures used under the standardized approach are 'Earnings at Risk' (net interest income) and 'Duration Gap' (economic value of equity), and the greater of the two is considered to be the interest rate risk for the period.

The net interest income and economic value of equity result from the differences between yields earned on the Bank's assets and interest rate paid on its liabilities and between the maturity and re-pricing mismatch (gap) of its assets and liabilities, respectively. These mismatches are inherent in the operations of the Bank and expose it to adverse changes in the level of interest rates.

The following table details assets and liabilities on the basis of the earlier of contractual maturity or re-pricing date. Use of tables to derive information about the Bank's interest rate risk position is limited by the fact that the actual re-pricing date of many financial instruments is different from the earlier of contractual maturity or re-pricing date. Examples of this include mortgages, which are shown at contractual maturity but which often repay earlier, and certain term deposits, which are shown at contractual maturity but which often cash out earlier.

| | Floating | Within 3 months | Over 3 – 12 months | Over 1 – 5 years | Over 5 years | Non-interest sensitive | Total |
|---|---|---|---|---|---|---|---|
| | $ | $ | $ | $ | $ | $ | $ |
| Assets | | | | | | | |
| Cash | - | - | - | - | - | 3,266 | 3,266 |
| Deposits with other banks | 33,222 | 89,365 | - | - | - | 31,473 | 154,060 |
| Effective interest rate | - | 0.50% | - | - | - | - | - |
| Securities | - | 97,906 | - | - | - | - | 97,906 |
| Effective interest rate | - | 0.62% | - | - | - | - | - |
| Loans, net of allowance for credit losses | 1,107,793 | 37,449 | 83,804 | 101,376 | - | (8,888) | 1,321,534 |
| Effective interest rate | 3.38% | 2.48% | 3.50% | 2.95% | - | - | - |
| Other assets | - | - | - | - | - | 19,110 | 19,110 |
| Total assets | **1,141,015** | **224,720** | **83,804** | **101,376** | **-** | **44,961** | **1,595,876** |
| Liabilities and shareholder's equity | | | | | | | |
| Deposits payable on demand/notice | 170,141 | - | - | - | - | 229,067 | 399,208 |
| Deposits payable on a fixed date | 771 | 286,583 | 531,280 | 134,868 | 2 | - | 953,504 |
| Effective interest rate | 0.20% | 1.32% | 1.67% | 2.11 | 2.20 | - | - |
| Cheques and other items in transit | - | - | - | - | - | 18,286 | 18,286 |
| Other liabilities | - | - | - | - | - | 13,928 | 13,928 |
| Shareholder's equity | - | - | - | - | - | 210,950 | 210,950 |
| Total liabilities and shareholder's equity | **170,912** | **286,583** | **531,280** | **134,868** | **2** | **472,231** | **1,595,876** |
| Excess (deficiency) of assets over liabilities and shareholder's equity | **970,103** | **(61,863)** | **(447,476)** | **(33,492)** | **(2)** | **(427,270)** | - |

### 25. Financial instruments and risk management (continued)

*Earnings at Risk*

(Unit: Dollars in Thousands)

| Interest Rate Shock | Interest Income | Interest Expense | Net Interest Income | Change in NII |
|---|---|---|---|---|
| | $ | $ | $ | $ |
| -200bp | 33,371 | 9,092 | 24,279 | (4,407) |
| -100bp | 38,732 | 11,272 | 27,460 | (1,226) |
| -25bp | 42,971 | 14,505 | 28,466 | (220) |
| -10bp | 43,902 | 15,259 | 28,643 | (43) |
| No Change | 44,523 | 15,837 | 28,686 | 0 |
| 10bp | 45,177 | 16,457 | 28,720 | 34 |
| 25bp | 46,159 | 17,387 | 28,772 | 86 |
| 100bp | 51,064 | 22,038 | 29,026 | 340 |
| 200bp | 57,605 | 28,238 | 29,367 | 681 |

The table above shows the impact of various parallel interest rate shifts on net interest income. As of the end of December 2016, an immediate and sustained 200bp rise in interest rates would increase net interest income by roughly $681 thousand over the next 12 months. The same amount of drop in interest rates would decrease net income by approximately $4.4 million. Due to the Bank's portfolio structure, the drop in interest rates would have a more adverse effect on financial statements than the rise in interest rates. The earnings at risk exposure reported for this period is within the approved limit, and will continue to be monitored by the Risk Management Department in accordance with the Bank's risk appetite and authorized limits.

*Duration Gap*

Durations for each time band are used as recommended by the BASEL committee. The weighted gaps are aggregated across time bands to produce an estimate of the change in economic value of the Bank that would result from the assumed changes in interest rates. As shown below, the economic value of equity as of 2016 year-end is estimated to decrease by $6,532 when the interest rate shock of 200bp is applied.

| Time Band | Floating | 1D ~ 1M | 1 ~ 3M | 3 ~ 6M | 6 ~ 12M | 1 ~ 2Y | 2 ~ 3Y | 3 ~ 4Y | 4 ~ 5Y | 5~7Y | Over 7Y | Non-Rate | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Total Assets | 1,141,015 | 143,016 | 81,703 | 16,792 | 67,012 | 59,402 | 30,914 | 3,909 | 7,152 | 0 | 0 | 44,961 | 1,595,876 |
| Total Liab. & Equity | 170,912 | 118,784 | 167,799 | 190,699 | 340,581 | 92,401 | 15,109 | 24,125 | 3,233 | 2 | 0 | 472,231 | 1,595,876 |
| Excess (Deficit) | 970,103 | 24,232 | (86,096) | (173,907) | (273,569) | (32,999) | 15,805 | (20,216) | 3,919 | (2) | 0 | (427,270) | 0 |
| Proxy Duration | 0 | 0.04 | 0.16 | 0.36 | 0.71 | 1.38 | 2.25 | 3.07 | 3.85 | 5.08 | 6.63 | | |
| Interest Rate Shock | 0 | 2.00% | 2.00% | 2.00% | 2.00% | 2.00% | 2.00% | 2.00% | 2.00% | 2.00% | 2.00% | 2.00% | |
| VaR | 0 | 19 | (276) | (1,252) | (3,885) | (911) | 711 | (1,241) | 302 | 0 | 0 | 0 | (6,533) |

(In thousands of Canadian dollars, except otherwise noted)

### 25. Financial instruments and risk management (continued)

*Non-parallel Approach*

In addition to various parallel shocks, stress testing is adopted to further assess an outcome of the interest rate shock under a non-parallel approach, which is composed of four additional scenarios developed by the Bank. In each scenario, the Bank assumes the maximum downfall of interest rate to be 400bp, which is double the severity of the standardized approach. By identifying the worst case scenario of an unfavourable interest rate shock, the additional capital needed to cover such situations can be estimated. As shown below, the largest varied economic value of the worst scenario as of December 31, 2016 was $8,100K.

| Time Band | | Floating | 1D ~ 1M | 1 ~ 3M | 3 ~ 6M | 6 ~ 12M | 1 ~ 2Y | 2 ~ 3Y | 3 ~ 4Y | 4 ~ 5Y | 5~7Y | Over 7Y | Non-Rate | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Scenario 1 (Downward) | Interest Rate Shock | 0 | 3.50% | 3.00% | 2.50% | 2.00% | 1.50% | 1.00% | 0.50% | 0.00% | -0.50% | | | |
| | VaR | 0 | 34 | (413) | (1,565) | (3,885) | (683) | 356 | (310) | 0 | 0 | 0 | | (6,466) |
| Scenario 2 (Downward) | Interest Rate Shock | 0 | 4.00% | 3.50% | 3.00% | 2.50% | 2.00% | 1.50% | 1.00% | 0.50% | -0.50% | | | |
| | VaR | 0 | 39 | (482) | (1,878) | (4,856) | (911) | 533 | (621) | 75 | 0 | 0 | | (8,101) |
| Scenario 3 (Upward) | Interest Rate Shock | 0 | -0.50% | 0.00% | 0.50% | 1.00% | 1.50% | 2.00% | 2.50% | 3.00% | 3.50% | | | |
| | VaR | 0 | (5) | 0 | (313) | (1,942) | (683) | 711 | (1,552) | 453 | 0 | 0 | | (3,331) |
| Scenario 4 (Upward) | Interest Rate Shock | 0 | -0.50% | 0.50% | 1.00% | 1.50% | 2.00% | 2.50% | 3.00% | 3.50% | 4.00% | | | |
| | VaR | 0 | (5) | (69) | (626) | (2,914) | (911) | 899 | (1,862) | 528 | 0 | 0 | | (4,960) |

*Liquidity risk*

*Liquidity risk is the risk that the Bank may be unable to generate or obtain sufficient cash or its equivalent in a timely and cost-effective manner to meet the commitment as it comes due. The most common sources of liquidity risk arise from mismatches in the timing and value to cash inflow and outflows, both from on- and off-balance sheet exposures.*

*The Bank's objective is to minimize liquidity risk. The Bank, to achieve this goal, operates to maintain:*

- Appropriate balance of liquidity on a daily, monthly, quarterly and semi-annual basis through matching strategy
- Broad funding access, including preserving and promoting a reliable base of core client deposits and ongoing access to diversified sources of wholesale funding
- A regularly updated liquidity contingency plan which is prepared based on liquidity stress-testing results
- Centralized liquidity management policies, practices and processes

The Bank monitors its liquidity situation by daily reporting, monthly liquidity risk evaluation, quarterly scenario testing and semi-annual measurement determining the required amount to survive extra three days until the Bank receives line of credit from the parent bank. Three stress scenarios reflecting events that can impact the funding operations of the Bank are tested and reported at the Board of Directors meeting and Risk Management Committee on a quarterly basis. The scenarios give a quantitative assessment of the Bank's funding needs in the event of stressed market environment.

The following is the maturity analysis of financial liabilities:

(In thousands of Canadian dollars, except otherwise noted)

**25. Financial instruments and risk management (continued)**

| | 3 months or less | 3 months to 1 year | 1 year to 3 years | Over 3 years | 2016 Total |
|---|---|---|---|---|---|
| | $ | $ | $ | $ | $ |
| **Demand and notice deposits** | **399,208** | **-** | **-** | **-** | **399,208** |
| **Fixed term deposits** | **287,354** | **531,280** | **107,485** | **27,385** | **953,504** |
| **Cheques and other items in transit** | **18,286** | **-** | **-** | **-** | **18,286** |
| **Others** | **13,928** | **-** | **-** | **-** | **13,928** |
| **Total financial liabilities** | **718,776** | **531,280** | **107,485** | **27,385** | **1,384,926** |

| | 3 months or less | 3 months to 1 year | 1 year to 3 years | Over 3 years | 2015 Total |
|---|---|---|---|---|---|
| | $ | $ | $ | $ | $ |
| Demand and notice deposits | 54,151 | - | 261,103 | - | 315,254 |
| Fixed term deposits | 369,791 | 578,888 | 103,805 | 30,176 | 1,082,661 |
| Cheques and other items in transit | 18,064 | - | - | - | 18,064 |
| Others | 10,989 | - | - | - | 10,989 |
| Total financial liabilities | 452,995 | 578,888 | 364,908 | 30,176 | 1,426,968 |

*Credit risk*

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Bank’s loans and advances to customers and other banks and from securities. The Bank’s objective is to minimize the credit risk. In order to manage the credit risk, the Bank sets up and complies with the credit risk limits, and periodically monitors and measures the credit risk of financial instruments using the established methodology such as BASEL II Pillar 1 and 2 risk measurements.

Maximum credit risk exposure by portfolio and sector before allowance for impairment, gross of unearned discount and before credit risk mitigation as at December 31, 2016 and 2015 was:

| | | | **2016** | | | 2015 |
|---|---|---|---|---|---|---|
| Industry | **Drawn loans** | **Off statement of financial position guarantees** | **Total exposure** | Drawn loans | Off statement of financial position guarantees | Total exposure |
| | **$** | **$** | **$** | $ | $ | $ |
| Manufacturing | **31,403** | **23,222** | **54,625** | 31,335 | 23,591 | 54,926 |
| Retail/service | **211,599** | **8,650** | **220,249** | 234,251 | 13,136 | 247,387 |
| Building/construction | **313,328** | **3,373** | **316,701** | 325,789 | 506 | 326,295 |
| Household | **736,646** | **-** | **736,646** | 703,786 | - | 703,786 |
| Other | **38,868** | **1,863** | **40,731** | 35,597 | 2,063 | 37,660 |
| Total exposure | **1,331,844** | **37,108** | **1,368,952** | 1,330,758 | 39,296 | 1,370,054 |

(In thousands of Canadian dollars, except otherwise noted)

**25. Financial instruments and risk management (continued)**

Most of the Bank's loans are backed by collateral.

As of December 31, 2016 the fair value of collateral held to be realized upon power of sale for impaired loans is $Nil (2015 - $0). It is assumed that appraisal value obtained for the collateral approximates the fair value of collateral to be realized for power of sale. For conservative analysis, in case of the collateral which is on market for power of sale, lower of listing price or appraisal value is used to determine fair value. Details of fair value of collateral held for impaired loans are as follows:.

| Loan type | Collateral type | Fair value ($) |
|---|---|---|
| Impaired Loan (Commercial mortgages) | Commercial Property | - |
| Impaired Loan (Residential mortgages and Businss loans) | Residential Property | - |
| Total | | - |

An analysis of the Bank's assets, by geographic area, on the basis of the location of ultimate risk, is as follows:

| | **December 31, 2016** | December 31, 2015 |
|---|---|---|
| | **$** | $ |
| Canada | **1,537,234** | 1,541,215 |
| United States | **15,455** | 48,588 |
| Korea | **43,186** | 42,959 |
| Other international locations | **1** | 4 |
| | **1,595,876** | 1,632,766 |

Residential and Commercial mortgage loans secured by Canadian properties are considered as 'Canada' as of 2015 and 2014 fiscal year end.

*Currency risk*

Foreign exchange risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The risk is managed by maintaining an appropriate matching policy for its foreign currency denoted assets and liabilities. It is measured using a historical 10-day VaR which is the difference between the current portfolio value and the portfolio value determined as the first percentile (assuming VaR is derived at the 99 percent confidence interval) in the left-hand tail of the distribution constructed by the histogram of portfolio values. The 10-day risk factor changes are applied to the current value of the risk factors and the current portfolio is revalued using the 10-day risk factor changes as many times as the number of days in the historical sample. It is important to decide which data is to be used for historical simulation and the most recent three years of historical data is used to calculate the 10-day VaR.

| | **Dec. 2016** | | | **Dec. 2015** | | |
|---|---|---|---|---|---|---|
| | **USD** | **KRW** | **VaR** | **USD** | **KRW** | **VaR** |
| Basic Rate | 1.3480 | 0.00112377 | | 1.3875 | 0.00118080 | |
| Position (US$, KRW) | 5,477 | 262,151,290 | | 518 | 138,986,274 | |
| Evaluated Value (C$) | 7,384 | 294,598 | **-10,057** | 719 | 164,115 | **-5,092** |

(In thousands of Canadian dollars, except otherwise noted)

### 26. Fair value of assets and liabilities by category and level

IFRS 7, Financial Instruments - Disclosures establishes a hierarchal framework which prioritizes and ranks the level of market price observability used in measuring fair value and requires enhanced disclosures about fair value measurements. Market price observability is impacted by a number of factors, including the type of investment, the characteristics specific to the investment, and the state of the marketplace. Investments with readily-available actively quoted prices or for which fair value can be measured from actively-quoted prices in an orderly market will generally have a higher degree of market price observability and a lesser degree of judgment used in measuring fair value.

Financial assets and liabilities recorded at fair value on the Bank's statement of financial position are categorized based upon the level of judgment associated with the inputs used to measure their fair value.

Hierarchical levels, defined in IFRS 7 (27A) and directly related to the amount of subjectivity associated with inputs to fair valuation of these assets are as follows:

Level 1 - quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2 - inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly; and

Level 3 - inputs for the asset or liability that are not based on observable market data (unobservable inputs). Fair value is determined with at least one significant model assumption which is unobservable in the current market (i.e. limited trading volume) and therefore management exercises their judgment in determining the instrument's fair value.

The composition of the Bank's assets and liabilities under IFRS 7 hierarchy is as follows:

| **December 31, 2016** | **Total** | **Quoted price in active markets for identical assets (Level 1)** | **Significant other observable inputs (Level 2)** | **Significant unobservable inputs (Level 3)** |
|---|---|---|---|---|
| | **$** | **$** | **$** | **$** |
| Assets | | | | |
| Loans | **1,320,934** | **-** | **-** | **1,320,934** |
| Securities | **97,906** | **97,906** | **-** | |
| Liabilities | | | | |
| Deposits | **1,354,628** | **-** | **-** | **1,354,628** |

| December 31, 2015 | Total | Quoted price in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
|---|---|---|---|---|
| | $ | $ | $ | $ |
| Assets | | | | |
| Loans | 1,320,373 | - | - | 1,320,373 |
| Securities | 88,956 | 88,956 | - | |
| Liabilities | | | | |
| Deposits | 1,399,693 | - | - | 1,399,693 |

The Bank did not have any significant transfers between Levels 1, 2 and 3 during the years ended December 31, 2016 and 2015.

## 27. Financial statements authorization

When the financial statements are approved by the Board of Directors at the shareholders' meeting, they are authorized for issue. The Board of Directors have power to amend the financial statements after they have been issued in case of unusual circumstances that significantly affect financial statement items. The financial statements were authorized for issue on June 23, 2017.