FIRST NATIONAL

FINANCIAL CORPORATION

Delivering Service
Creating Solutions
Building Success

2013 ANNUAL REPORT

2013
At a Glance

$197.6
Million

Earnings before income taxes, depreciation and amortization, and losses and gains on financial instruments ("Pre-FMV EBITDA") reached a new record, **29% above 2012**. Management uses this non-IFRS measure as an indicator of operational performance.

50%

Pre-FMV **return on shareholders' equity in 2013 of 50%** was well in line with First National's three-year average of 46% and shows the Company's efficient use of capital.

7

First National increased its common share dividend for the seventh time since its initial public offering, effective for the dividend payable on April 15, 2014. This raises the **annualized rate per common share to $1.50**.

77%

First National paid **77% of its adjusted cash flow in common share dividends in 2013**, even though it also increased the dividend rate in April of 2013 and invested in more securitization transactions.

Letter from the President

Fellow Shareholders:
First National celebrated the 25th anniversary of its founding and its seventh anniversary as a public company on the S&P/TSX in 2013 with excellent results.

Mortgages under administration (MUA) grew 12 percent to a record $75.6 billion as a result of record origination volumes and strong renewals. Single-family segment MUA at year end was $57.7 billion, up $8.1 billion from 2012, while commercial segment MUA was $18 billion, up $400 million year over year.

Stephen Smith,
Chairman,
President and Chief Executive Officer

At $14.1 billion, originations exceeded 2012 by one percent or about $100 million in spite of government measures designed to moderate consumer debt, primarily related to mortgages. We were particularly pleased by the steady quarter-to-quarter recovery in single-family origination volumes throughout the year, culminating in a 32 percent year-over-year growth in the fourth quarter of 2013. Commercial segment originations were 16 percent or $424 million higher than in 2012 – an excellent outcome.

Revenue grew 24 percent to $776.5 million from $628.6 million in 2012 due to growth in the business and gains on financial instruments, which accounted for six percent of the increase. Net income before taxes increased 55 percent to $233.5 million from $150.8 million a year ago, while Pre-FMV EBITDA reached a record level of $197.6 million, 29 percent above 2012.

Strong cash flow supported an increase in the common share dividend in 2013, to an annualized rate of $1.40 per share. Even so, the payout ratio, calculated on the basis of adjusted cash flow available for common shares, was 77 percent in 2013, providing more than enough surplus cash to fuel growth initiatives and to give our Board the confidence to raise the common share dividend once again, commencing with the dividend payment in April 2014. This latest increase brings the annualized common share dividend rate to $1.50 per common share or $0.1250 per month. Since our initial public offering, our Board has approved seven increases to the common share dividend.

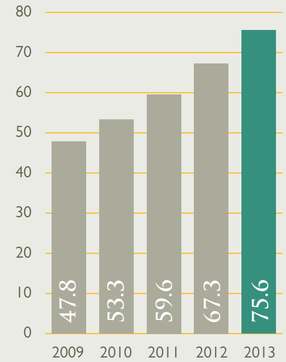
These results reinforce First National's standing as Canada's largest non-bank originator and underwriter of residential mortgages, and one of Canada's largest commercial lenders. They also reflect First National's greatest strengths: a sustainable business model, which continues to be as relevant and resilient today as it was a quarter century ago; industry-leading technology systems; and, most fundamentally, the diligent efforts of our employees. Their commitment to delivering service, creating solutions and building success has made First National a first choice for mortgage brokers and borrowers across Canada.

Corporate profile
First National Financial Corporation (TSX: FN, FN.PR.A) is the parent company of First National Financial LP, a Canadian-based originator, underwriter and servicer of predominantly prime residential (single-family and multi-unit) and commercial mortgages. With over $75 billion in mortgages under administration, First National is Canada's largest non-bank originator and underwriter of mortgages and is among the top three in market share in the mortgage broker distribution channel.
For more information, please visit www.firstnational.ca.

2013 at a glance

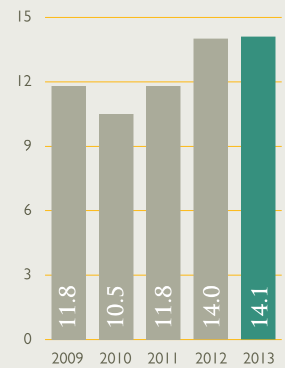
MORTGAGES UNDER ADMINISTRATION
(in $ billions)

12%
YEAR-OVER-YEAR GROWTH
2012 TO 2013



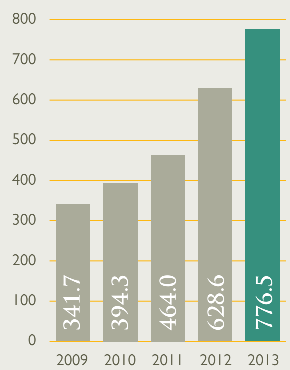
MORTGAGE ORIGINATIONS
(in $ billions)

1%
YEAR-OVER-YEAR GROWTH
2012 TO 2013



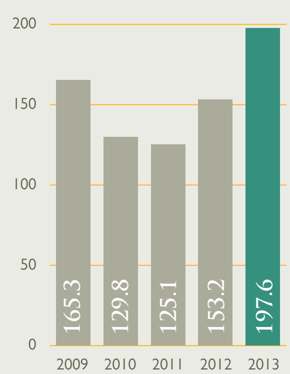
REVENUE
(in $ millions)

24%
YEAR-OVER-YEAR GROWTH
2012 TO 2013



PRE-FMV EBITDA
(in $ millions)

29%
YEAR-OVER-YEAR GROWTH
2012 TO 2013



Strength to strength

Ensuring that First National is successful for the next 25 years and beyond is of paramount importance. One of the ways to build success for the future is to do what we have done in the past: vigorously support the mortgage broker channel. In 2013, First National continued to advocate for the channel because we believe in the expertise, service and value provided by mortgage brokers. We will do so again in 2014, and for the long term.

More than this, the Company will strive, as it has in the past, to meet mortgage broker expectations for service. First National sets rigorous national standards for application turnaround time and funding execution, tracks the performance of each of our offices against these measures and publishes the results internally. This creates friendly competition and helps First National consistently achieve its service objectives, as it did once again in 2013.

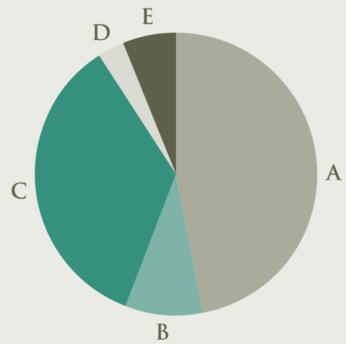
First National would not be where it is today without the mortgage broker channel. In 2013, we recognized this fact with our *25 Years of Shared Success* campaign, which finished in early 2014. Going forward, we will continue to empower mortgage brokers, who now account for about 30 percent of all mortgage originations in Canada, with the tools they need to grow their businesses and fulfill customer needs. By doing so, First National should continue to find success in the years ahead.

Technology at First National has always been a complement to personal service and will remain an important tool for growth and service differentiation for the Company. The desire to support mortgage brokers with best-in-class service was the driving force behind MERLIN, the industry's first online mortgage approval and tracking system. Introduced in 2001, MERLIN increases transparency in lender underwriting for mortgage brokers as they deliver rapid-response service to borrowers. We continue to refine this proprietary technology as it provides First National with a clear and meaningful competitive advantage in the Canadian mortgage market.

For borrowers, we provide *My Mortgage*, our online mortgage management tool. It allows borrowers to view their current mortgage balances, change payment dates, and calculate interest savings from increasing payment frequencies or doubling up on payments. It was used more than 440,000 times by over 72,000 borrowers in 2013, and in early 2014 we added new functionality so borrowers can chat live over the Internet with our customer service representatives. *My Mortgage* will feature prominently in our customer service efforts in the years ahead.

Securitization has also contributed materially to the growth of our business since our founding and will continue to play an important role going forward. About $4.1 billion of originations in 2013 were securitized directly by the Company into National Housing Act Mortgage-Backed Securities ("NHA MBS"), Canada Mortgage Bonds and Asset-backed Commercial Paper programs as First National took advantage of the demand for government-insured securities and profitable interest rate spreads. Securitizing mortgages efficiently uses the Company's capital, leading to enhanced future cash flows and creating independence from institutional customers.

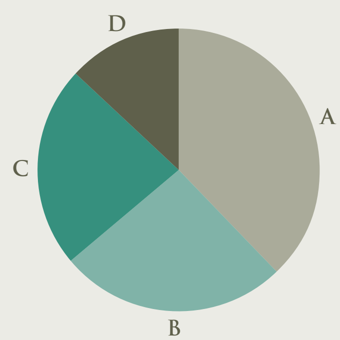
2013 at a glance



FUNDING SOURCES

(for the year ended December 31, 2013)

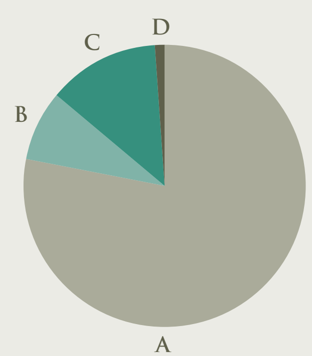
A	47%	Institutional placements
B	9%	CMB dealers
C	35%	NHA MBS
D	3%	ABCP
E	6%	Internal resources



REVENUE SOURCES PRIOR TO FAIR VALUE GAINS/LOSSES

(for the year ended December 31, 2013)

A	38%	Institutional placements
B	26%	Net interest – securitized mortgages
C	23%	Mortgage servicing
D	13%	Investment income



MORTGAGES UNDER ADMINISTRATION

(for the year ended December 31, 2013)

A	79%	Insured
B	8%	Multi-unit residential and commercial
C	13%	Conventional single-family residential
D	<1%	Bridge loans / Alt-A
	92%	Insured or conventional single-family residential

Looking forward

We anticipate that the low interest rate environment in Canada will continue with moderated, but still healthy, mortgage spreads. We expect to fund almost $20 billion of mortgages in 2014 by realizing significant renewal opportunities and focusing on partnerships with our institutional customers. Although origination volumes are expected to be similar to the record set in 2013, we intend to capitalize on expected volumes of mortgage renewals and generate cash flow from First National's almost $18 billion portfolio of mortgages pledged under securitization in order to maximize financial performance.

Experience counts

In closing, we are proud of First National's place in the residential and commercial mortgage industry, proud of our employees and proud to partner with so many dedicated professionals in the Canadian mortgage market.

In an industry where experience counts, the knowledge and insight we have gained and the relationships we have forged over the past quarter century make First National a vibrant business that is well prepared to meet the challenges and capitalize on the opportunities that lie ahead in Canada's real estate and mortgage markets.

I sincerely thank our customers and shareholders for your loyalty, and our Board of Directors, senior leaders and all employees for your hard work and dedication during this year of progress and performance.

Yours sincerely,

Stephen Smith

Stephen Smith
Chairman, President and Chief Executive Officer

Our Management Team

From left to right:

Lisa White, Vice President, Mortgage Administration
Scott McKenzie, Senior Vice President, Residential Mortgages
Stephen Smith, Chairman, President and Chief Executive Officer
Moray Tawse, Executive Vice President
Jeremy Wedgbury, Senior Vice President, Commercial Mortgages
Robert Inglis, Chief Financial Officer
Jason Ellis, Managing Director, Capital Markets
Hilda Wong, General Counsel

Our Philosophy

Our philosophy is unique in its simplicity: we deliver service, create solutions and build success.

By combining innovative mortgage solutions with MERLIN – our industry-leading mortgage approval and tracking system – and the expertise of our team, First National has earned the trust of mortgage brokers, commercial clients and residential customers Canada-wide.

These valued relationships endure because of our unwavering commitment to service excellence, a commitment shared by senior management and every member of the First National team.

Delivering Service

We are determined to provide industry-leading service across all areas of our business.

Fast turnaround of mortgage applications is a priority at First National. We typically respond to mortgage broker submissions within four hours and commercial clients often receive their mortgage commitment documents in as little as seven days.

A homeowner who becomes a First National client can expect dedicated service from our experienced team of customer service representatives, and access to *My Mortgage*, their personalized mortgage management tool available online or by phone.

Residential mortgage brokers have access to a wide range of mortgage solutions, flexible payment terms and prepayment privileges to suit just about any lifestyle.

MERLIN, First National's exclusive online mortgage approval and tracking system, ensures mortgage brokers stay connected to the status of their deal so they can exceed customers' expectations while maximizing efficient use of their own time.

Creating Solutions

At First National, we put all of our resources and expertise behind the development, administration and servicing of mortgage solutions.

Each commercial mortgage inquiry starts with a professional mortgage consultation and analysis. Our commercial mortgage experts analyze each client's needs and develop customized proposals detailing the loan strategy, preferred terms, best rate solution and optimum financing recommendation.

Building Success

Many Canadians dream of buying their first home whether they are new to our country, growing a family or simply putting down roots. Together with their mortgage broker, we are all committed to helping them make this dream come true, as easily and worry-free as possible.

Time and time again, mortgage brokers tell us that a key component of excellent service is fast turnaround time so that they can differentiate themselves from the competition. First National responds to 90% of mortgage broker submissions in under four hours.

FINANCIAL REPORTING

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2013 Financial Statements

Management's Discussion and Analysis

The following management's discussion and analysis ("MD&A") of financial condition and results of operations is prepared as of February 25, 2014. This discussion should be read in conjunction with the audited consolidated financial statements of First National Financial Corporation (the "Company" or "Corporation" or "First National") as at and for the year ended December 31, 2013 and the notes thereto. This discussion should also be read in conjunction with the audited consolidated financial statements and notes thereto of the Company for the year ended December 31, 2012. The audited consolidated financial statements of the Company have been prepared in accordance with International Financial Reporting Standards ("IFRS").

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

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

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

General Description of the Company

First National Financial Corporation is the parent company of First National Financial LP ("FNFLP"), a Canadian-based originator, underwriter and servicer of predominantly prime residential (single-family and multi-unit) and commercial mortgages. With over $75 billion in mortgages under administration ("MUA"), First National is Canada's largest non-bank originator and underwriter of mortgages and is among the top three in market share in the growing mortgage broker distribution channel.

Commencing in 2013, First National has also consolidated its interest in First National Mortgage Investment Fund (the "Fund"), which it launched in late 2012. Although the Company owns about 16% of the units issued by the Fund, because of its status as sole seller to the Fund and its rights as promoter, IFRS deems that First National exercises control over the Fund. The Fund was created to obtain economic exposure to a diversified portfolio of primarily commercial mezzanine mortgages. Through the Fund's consolidation, the Company has effectively taken on a portfolio of about $69 million (2012 – $23 million) of mortgages. Because of the Company's small proportionate interest in the Fund's units, it has also recorded a $45 million (2012 – $42 million) non-controlling interest in equity which offsets these assets. The December 31, 2012 financial results of the Company have been retroactively restated to include the Fund's assets and liabilities together with the non-controlling interest at that date.

2013 Results Summary

The Company was very pleased with its results for 2013. The Canadian real estate market remained solid despite a cyclical slowdown in housing sales and the federal government's initiatives announced in 2012 to reduce consumer debt. This was particularly true for the single-family segment where First National's origination was off by only 3% when compared to 2012. This is a marked improvement from the first quarter of 2013 when single-family origination was down 20% from the prior year's quarter. With a strong contribution from origination in its commercial segment business, the Company set a new record for origination with over $14 billion of mortgages originated in the year. These volumes enabled the Company to grow its MUA and build the value of its portfolio of securitized mortgages.

- MUA grew to $75.6 billion at December 31, 2013 from $67.3 billion at December 31, 2012, an increase of 12%; the growth from September 30, 2013, when MUA was $74.0 billion, was approximately 2%, an annualized increase of 9%;
- The Canadian single-family real estate market, which slowed markedly in the first quarter of 2013, turned more favourable for the rest of the year. Single-family mortgage originations for the Company decreased by 3% to $10.9 billion in 2013 from $11.3 billion in 2012. The commercial segment had a strong year as this market remained strong; volumes increased by 16%, from $2.7 billion in 2012 to $3.1 billion in 2013. Together, overall origination increased by just under 1% year over year;
- During 2013, the Company used the Canada Mortgage Bonds ("CMB") program to successfully securitize about $750 million of multi-unit mortgages in the 10-year program and $1.2 billion of single-family mortgages in the five-year term program. First National also securitized $174 million of mortgages for CMB replacement purposes in the year;
- Revenue for 2013 increased to $776.5 million from $628.6 million in 2012. The growth of 24% is reflective of a growing business, augmented by the change on account of financial instruments, which increased revenue by about 6%. Interest revenue from securitized mortgages increased revenue by $92.2 million or 15% year over year;
- Income before income taxes in the year increased by 55%, from $150.8 million in 2012 to $233.5 million in 2013. The increase was due in part to rising interest yields in the bond market, which favourably affected the Company's interest rate hedges. Income before income taxes was comparatively higher in 2013 than 2012 by $37.7 million because of the favourable change in gains on financial instruments; and
- Without the impact of gains and losses on financial instruments, which have been volatile, the Company's earnings before income taxes, depreciation and amortization ("Pre-FMV EBITDA") for the year increased by 29.0%, from $153.2 million in 2012 to $197.6 million in 2013. This increase is due to the steady growth of the Company's core business, including increased net margin on securitized mortgages and mortgage investment income.

The Company was pleased with its results and, in particular, the amount of cash flow the business generated. With a strong finish to 2013, First National is pleased to announce that the Board of Directors has approved an increase in the dividend payable on the outstanding common shares. Effective with the dividend payable on April 15, 2014, the annual dividend rate will be increased from $1.40 per share to $1.50 per share, an increase of 7.1%.

Outstanding Securities of the Corporation

At December 31, 2013 and February 25, 2014, the Corporation had 59,967,429 common shares, 4,000,000 Class A preference shares, Series 1 and 175,000 debentures outstanding.

Selected Quarterly Information

Quarterly results of First National Financial Corporation

($000s, except per share amounts)

	Revenue	Net income for the period	Pre-FMV EBITDA for the period[1]	Net income per common share	Total assets
2013					
Fourth quarter	$ 200,928	$ 41,821	$ 53,401	$ 0.66	$ 20,569,217
Third quarter	$ 200,522	$ 39,399	$ 56,124	$ 0.63	$ 19,930,780
Second quarter	$ 229,830	$ 67,845	$ 51,193	$ 1.10	$ 18,793,683
First quarter	$ 145,228	$ 23,036	$ 36,864	$ 0.36	$ 17,163,697
2012					
Fourth quarter	$ 156,092	$ 33,491	$ 41,765	$ 0.54	$ 15,022,236
Third quarter	$ 181,573	$ 32,047	$ 40,597	$ 0.51	$ 14,311,584
Second quarter	$ 156,983	$ 18,099	$ 39,610	$ 0.28	$ 13,682,980
First quarter	$ 133,965	$ 26,688	$ 31,227	$ 0.43	$ 13,224,456

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

Given First National's large amount of MUA and portfolio of mortgages pledged under securitization, quarterly revenue under IFRS is driven primarily by mortgage servicing revenue growth and the gross interest earned on the mortgages pledged under securitization. Servicing revenue will change as the third-party portfolio of mortgages grows or contracts. The gross interest on the mortgage portfolio is dependent both on the size of the portfolio of mortgages pledged under securitization as well as weighted average mortgage rates. All of these factors have increased over the last 24 months as the Company has steadily increased MUA and its portfolio of securitized mortgages. Net income is also dependent on conditions in the debt markets, which affect the value of gains and losses on financial instruments arising from the Company's interest rate hedging program. Accordingly, the movement of this measurement between quarters is related to factors external to the business of the Company (primarily conditions in the bond markets). By removing this volatility and analyzing Pre-FMV EBITDA, a clearer view of the Company's performance can be assessed.

Generally, in the last eight quarters the Company has endeavoured to grow its origination volumes in order to build its servicing portfolio and to enable it to securitize larger amounts of mortgages in the NHA MBS market. This longer-term strategy has been successful and Pre-FMV EBITDA has grown steadily to over $197 million for 2013. The table above shows a trend of growing income reflecting typical Canadian seasonality: slower first quarters and stronger subsequent quarters.

Selected Annual Financial Information for the Company's Fiscal Year

($000s, except per share amounts)

	December 31 2013	December 31 2012	December 31 2011
For the year then ended			
Income statement highlights			
Revenue	$ 776,508	$ 628,613	$ 464,020
Interest expense – securitized mortgages	(323,236)	(246,736)	(184,291)
Brokerage fees	(84,420)	(115,978)	(81,480)
Salaries, interest and other operating expenses	(127,404)	(106,547)	(91,642)
Add (deduct): realized and unrealized (gains) losses on financial instruments	(43,866)	(6,153)	18,485
Pre-FMV EBITDA(1)	197,582	153,199	125,092
Amortization of capital assets	(2,374)	(2,059)	(1,856)
Amortization of intangible assets	(5,563)	(6,468)	(7,968)
Add (deduct): realized and unrealized gains (losses) on financial instruments	43,866	6,153	(18,485)
Provision for income taxes	(61,410)	(40,500)	(26,292)
Net income	172,101	110,325	70,491
Dividends declared	90,294	80,859	109,022
Per share highlights			
Net income per common share	2.75	1.76	1.10
Dividends per common share	1.38	1.27	1.25
At year end			
Balance sheet highlights			
Total assets	20,569,217	15,022,236	11,927,270
Total long-term financial liabilities	$ 179,195	$ 181,275	$ 184,689

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

Vision and Strategy

The Company provides mortgage financing solutions to virtually the entire mortgage market in Canada. By offering a full range of mortgage products, with a focus on customer service and superior technology, the Company believes that it is the leading non-bank mortgage lender in the industry. Growth has been achieved while maintaining a relatively conservative risk profile. The Company intends to continue leveraging these strengths to lead the "non-bank" mortgage lending industry in Canada, while appropriately managing risk.

The Company's strategy is built on four cornerstones: providing a full range of mortgage solutions; growing assets under administration; employing leading-edge technology to lower costs and rationalize business processes; and maintaining a conservative risk profile. An important element of the Company's strategy is its direct relationship with the mortgage borrower. Although the Company places most of its originations with third parties, FNFLP is perceived by most of its borrowers as the mortgage lender. This is a critical distinction. It allows the Company to communicate with each borrower directly throughout the term of the related mortgage.

Through this relationship, the Company can negotiate new transactions and pursue marketing initiatives. Management believes this strategy will provide long-term profitability and sustainable brand recognition for the Company.

Key Performance Drivers

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

- Growth in the portfolio of mortgages under administration;
- Growth in the origination of mortgages;
- Lowering the costs of operations through the innovation of systems and technology; and
- Employing innovative securitization transactions to minimize funding costs.

Growth in Portfolio of Mortgages under Administration

Management considers the growth in MUA to be a key element of the Company's performance. The portfolio grows in two ways: through mortgages originated by the Company and through third-party mortgage servicing contracts. Mortgage originations not only drive revenues from placement and interest from securitized mortgages, but perhaps more importantly, longer-term values such as servicing fees, mortgage administration fees, renewal opportunities and the growth of the customer base for marketing initiatives. As at December 31, 2013, MUA totalled $75.6 billion, up from $67.3 billion at December 31, 2012, an increase of 12%. This compares to $74.0 billion at September 30, 2013, representing a quarter-over-quarter increase of 2% and an annualized increase of about 9%.

Growth in Origination of Mortgages

The origination of mortgages not only drives the growth of MUA as described above, but leverages the Company's origination platform, which has a large fixed cost component. As more mortgages are originated, the marginal costs of underwriting are decreased. The Company can also decide to securitize more mortgages to take advantage of its origination in periods of wider mortgage spreads. Prior to 2008, when the capital markets experienced some significant turbulence, the prime mortgages that the Company originated had tight spreads such that the Company's strategy was to sell these mortgages on commitment to institutional investors and retain the servicing. This strategy changed with the challenges in the credit environment and the Company was able to take a larger portion of the spread for itself. By the end of 2010, much of the turmoil in the capital markets had waned and mortgage spreads had returned to modest premiums over pre-crisis levels. This is most evident for five-year fixed rate single-family mortgage rates compared to similar-term Government of Canada bonds. Prior to 2008, this comparison showed spreads of approximately 1.25%. With the credit crisis, these spreads reached as high as 3.00% in 2008. Between 2009 and mid-2011, spreads gradually tightened as liquidity issues at financial institutions diminished and the competition for mortgages increased such that at June 30, 2011, mortgage spreads were at 1.46%. With renewed global economic turmoil in 2012, spreads generally widened again, reaching as high as 1.85% until tightening to about 1.61% by year end. Rates rose in 2013 as interest rates began to rise and spreads approached 1.85%. With competitive pressures toward year end, spreads tightened to about 1.50%. In 2013, the Company chose to continue its securitization strategy but use a larger portion of its renewal volume to achieve its annual targets. However, a still significant portion of its new origination, in both the single-family and multi-family segments, will be used for securitization to take advantage of these still profitable spreads. In 2013, the Company originated for securitization approximately $3.6 billion of single-family mortgages and $809 million of multi-unit residential mortgages in order to take advantage of these spreads. In 2013, the Company securitized through NHA MBS approximately $420 million of floating rate single-family mortgages, $4.7 billion of fixed rate single-family mortgages and $795 million of fixed rate multi-unit residential mortgages.

Lowering Costs of Operations

Innovations in systems and technology

The Company has always used technology to provide for efficient and effective operations. This is particularly true for its MERLIN underwriting system, Canada's only web-based, real-time broker information system. By creating a paperless, 24/7 commitment management platform for mortgage brokers, the Company is now ranked among the top three lenders by market share in the broker channel. This has translated into increased single-family origination volumes and higher closing ratios (the percentage of mortgage commitments the Company issues that actually become closed mortgages).

Increase of bank credit facility

The Company uses a revolving line of credit with a syndicate of banks. At December 31, 2013, the commitment under the facility totalled $570 million. This facility enables the Company to fund the increasing amount of mortgages accumulated for securitization. The entire facility is floating rate and has a four-year term. The Company has elected to undertake this increased debt for a number of reasons: (1) the transaction increases the amount of debt available to fund mortgages originated for securitization purposes; (2) the debt is revolving and can be used and repaid as the Company requires, providing more flexibility than the debenture debt, which is always fully drawn; (3) the four-year term extension gives the Company a committed facility that strategically extends the maturity of this debt beyond that of the debenture in 2015; and (4) the cost of borrowing reflects the Company's BBB issuer rating. Subsequent to December 31, 2013, the Company increased the bank syndicate credit facility to $1 billion.

Preferred share issuance

On January 25, 2011, the Company issued 4,000,000 Class A preference shares, Series 1, for gross proceeds of $100 million. The Company received net proceeds of $97.4 million after issuance costs net of deferred tax assets of $0.9 million. These shares are rate reset preferred shares having a stated 4.65% annual dividend rate, subject to Board of Director approval, and a par value of $25 per share. The rate reset feature is at the discretion of the Company such that after the initial five-year term, the Company can choose to extend the shares for another five-year term at a fixed spread (2.07%) over the yield of the then-relevant Government of Canada bond. While the investors in these shares have an option on each five-year anniversary to convert their Series 1 holdings into Series 2 preference shares (which pay floating rate dividends), there are no redemption options for these shareholders. As such, the Company considers these shares to represent a permanent source of capital and classifies the shares as equity on its balance sheet. Management believes this capital will give the Company the opportunity to pursue its strategy of increased securitization, which requires upfront investment.

Employing Innovative Securitization Transactions to Minimize Funding Costs

Approval as both an issuer of NHA MBS and seller to the Canada Mortgage Bonds program

The Company has been involved in the issuance of NHA MBS since 1995. This program has been very successful, with over $10 billion of NHA MBS issued. In December 2007, the Company was approved by Canada Mortgage and Housing Corporation ("CMHC") as an issuer of NHA MBS and as a seller into the CMB program. Issuer status has provided the Company with a funding source that it can access independently. Perhaps more importantly, seller status for the CMB gives the Company direct access to the CMB. Generally, the demand for high-quality fixed and floating rate investments increased significantly with the turmoil in 2009. This demand has continued into 2013 and allowed the Company to fund over $5.9 billion of mortgages through the NHA MBS and CMB programs during the year. In August 2013, CMHC announced that it would be limiting the amount of guarantees it would issue on NHA MBS pools created for sale to the "market". CMHC indicated that the amount of guarantees it was providing for such market pools (primarily any pool not sold to the Canada Housing Trust ("CHT") for the CMB) was growing significantly. In order to better control the absolute amount of risk that it takes on in this respect, CMHC will implement policies to allocate the amount of guarantees it provides in future. The current amount being allocated to each issuer is approximately the amount that First National is using each month, but the new policies could restrict the amount of growth the Company can plan for in the MBS market. These rules are similar to the CMB allocation rules described below, which have been in place since 2008.

Canada Mortgage Bonds program

The CMB program is an initiative sponsored by CMHC whereby the CHT issues securities to investors in the form of semi-annual interest-yielding five- and 10-year bonds. Pursuant to the Company's approval as a seller into the CMB, the Company is able to make direct sales into the program. Because of the similarities to a traditional Government of Canada bond (both have five- and 10-year unamortizing terms and a federal government guarantee), the CMB trades in the capital markets at a modest premium to the yields on Government of Canada bonds. The ability to sell into the CMB has given the Company access to lower costs of funds on both single-family and multi-family mortgage securitizations. Because these funding structures do not amortize, the Company can fund future mortgages through this channel as the original mortgages amortize or pay out. The Company also enjoys demand for mortgages from investment dealers who sell directly into the CMB. Because of the effectiveness of the CMB, there have been requests from approved CMB sellers for larger issuances. CHT has indicated that it will not unduly increase the size of its issuances and has created guidelines through CMHC that limit the amount that can be sold by each seller into the CMB each quarter. The Company is subject to these limitations.

Key Performance Indicators

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

- Earnings before income taxes, depreciation and amortization, and losses and gains on financial instruments ("Pre-FMV EBITDA"(1)); and
- Adjusted cash flow from operations ("Adjusted Cash Flow").

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

($000s)	**Quarter ended**		**Year ended**	
	December 31 2013	**December 31 2012**	**December 31 2013**	**December 31 2012**
For the period				
Revenue	**$ 200,928**	$ 156,092	**$ 776,508**	$ 628,613
Income before income taxes	**57,531**	45,091	**233,511**	150,825
Pre-FMV EBITDA(1)	**53,401**	41,765	**197,582**	153,199
At period end				
Total assets	**20,569,217**	15,022,236	**20,569,217**	15,022,236
Mortgages under administration	**75,619,003**	67,260,086	**75,619,003**	67,260,086

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

Adjusted Cash Flow is not a defined term under IFRS. Management believes that net cash generated by the Company prior to investing and financing activities is an important measure for investors to monitor. Management cautions investors that, due to the Company's nature as a mortgage seller and securitizer, there will be significant variations in this measure from quarter to quarter as the Company collects and invests cash from mortgage transactions. Adjusted Cash Flow is determined by the Company as cash provided from operating activities increased/decreased by the change in mortgages accumulated for sale or securitization in the period. Mortgages accumulated for sale or securitization consist primarily of mortgages that the Company funds ahead of securitization transactions. Normally, during the three months after funding, the Company aggregates all relevant mortgages "warehoused" to date and creates a pool to sell to the NHA MBS market or directly to the CMB. As the Company typically raises term debt through the securitization markets on these mortgages in the months subsequent to the month of funding, there are large amounts of cash invested at quarter ends. The Company's credit facilities provide full financing for the majority of these mortgage loans. Accordingly, management believes the measure of Adjusted Cash Flow is meaningful only if the change in mortgages accumulated for sale between reporting periods is adjusted. The calculation also adjusts for the cash needed for investment in capital assets.

Determination of Adjusted Cash Flow and Payout Ratio

($000s)	**Quarter ended**		**Year ended**	
	December 31 2013	**December 31 2012**	**December 31 2013**	**December 31 2012**
For the period				
Cash provided by (used in) operating activities	$ 299,833	$ 86,207	$ (150,672)	$ 166,597
Add (deduct):				
Change in mortgages accumulated for sale or securitization between periods	(278,470)	(53,378)	266,303	(42,416)
Additions to property, plant and equipment	(1,085)	(612)	(3,428)	(2,955)
Adjusted Cash Flow(1)	20,278	32,217	112,203	121,226
Less: cash dividends on preference shares	(1,162)	(1,162)	(4,650)	(4,650)
Adjusted Cash Flow available for common shareholders	$ 19,116	$ 31,055	$ 107,553	$ 116,576
Adjusted Cash Flow per common share ($/share)(1)	0.32	0.52	1.79	1.94
Dividends declared on common shares	20,987	19,490	82,955	76,209
Dividends declared per common share ($/share)	0.35	0.33	1.38	1.27
Payout ratio	109%	63%	77%	65%

(1) These non-IFRS measures adjust cash provided by (used in) operating activities by accounting for changes between periods in mortgages accumulated for sale or securitization and mortgage securitization activity.

For the year ended December 31, 2013, the payout ratio was 77%, higher than the 65% ratio reported in 2012. Although the Company recorded $172 million of net income in 2013, the Company invested $65 million in new securitizations, which reduced cash provided from operations. These costs include $21 million of net capitalized broker fees to originate the securitized mortgages and $39 million for MBS-related costs required to raise the securitization-related debt. Cash flow was also lower than income due to gains on financial instruments, as approximately $19 million of these gains were unrealized at year end. This was particularly apparent in the fourth quarter of 2013 when, despite net fair value gains, $4 million of realized losses offset cash flow. The Company also used cash resources in the termination of the Alt-A program. Approximately $5 million of defaulted mortgages in the program, previously funded with securitization debt, were funded with internal Company resources in October 2013. Together, these two items reduced fourth quarter cash flow per share by about $0.23. Without these two items, the payout ratio for the fourth quarter would have been approximately 63%. Overall, given the degree of investment in securitization, the Company is comfortable with 2013's payout ratio of 77%.

Revenues and Funding Sources

Mortgage origination

The Company derives a significant amount of its revenue from mortgage origination activities. Most mortgages originated are funded either by placement with institutional investors or through securitization conduits, in each case with retained servicing. Depending upon market conditions, either an institutional placement or a securitization conduit may be the most cost-effective means for the Company to fund individual mortgages. In general, originations are allocated from one funding source to another depending on market conditions and strategic considerations related to maintaining diversified funding sources. The Company retains servicing rights on virtually all of the mortgages it originates, which provides the Company with servicing fees to complement revenue earned through originations. For the year ended December 31, 2013, origination volume increased from $14.0 billion to $14.1 billion, or less than 1%, compared to fiscal 2012.

Securitization

The Company securitizes a portion of its origination through various vehicles, including NHA MBS, CMB and Asset-backed Commercial Paper ("ABCP"). Although legally these transactions represent sales of mortgages, for accounting purposes they do not meet the requirements for revenue recognition and instead are accounted for as secured financings. These mortgages remain as mortgage assets of the Company for the full term and are funded with securitization-related debt. Of the Company's $14.1 billion of originations for the year ended December 31, 2013, $4.4 billion was originated for securitization purposes.

Placement fees and gain on deferred placement fees

The Company recognizes revenue at the time that a mortgage is placed with an institutional investor. Cash amounts received in excess of the mortgage principal at the time of placement are recognized in revenue as "placement fees". The present value of additional amounts expected to be received over the remaining life of the mortgage sold (excluding normal market-based servicing fees) is recorded as a deferred placement fee. A deferred placement fee arises when mortgages with spreads in excess of a base spread are sold. Normally the Company would earn an upfront cash placement fee, but investors prefer paying the Company over time as they earn net interest margin on such transactions. Upon the recognition of a deferred placement fee, the Company establishes a "deferred placement fee receivable" that is amortized as the fees are received by the Company. Of the Company's $14.1 billion of originations for the year ended December 31, 2013, $7.9 billion was placed with institutional investors and $1.3 billion was originated for institutional investors involved in the issuance of NHA MBS.

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

Mortgage servicing and administration

The Company services virtually all mortgages generated through its mortgage origination activities on behalf of a wide range of institutional investors. Mortgage servicing and administration is a key component of the Company's overall business strategy and a significant source of continuing income and cash flow. In addition to pure servicing revenues, fees related to mortgage administration are earned by the Company throughout the mortgage term. Another aspect of servicing is the administration of funds held in trust, including borrowers' property tax escrow, reserve escrow and mortgage payments.

As acknowledged in the Company's agreements, any interest earned on these funds accrues to the Company as partial compensation for administration services provided. The Company has negotiated favourable interest rates on these funds with the chartered banks that maintain the deposit accounts, which has resulted in significant additional servicing revenue.

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

Results of Operations

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

($ millions)	Quarter ended		Year ended	
	December 31 2013	December 31 2012	December 31 2013	December 31 2012
Mortgage originations by segment				
Single-family residential	$ 2,496	$ 1,919	$ 10,925	$ 11,280
Multi-unit residential and commercial	887	832	3,133	2,709
Total	$ 3,383	$ 2,751	$ 14,058	$ 13,989
Mortgage originations by funding source				
Institutional investors – residential	$ 1,704	$ 1,246	$ 7,131	$ 8,926
Institutional investors – multi-unit/commercial	205	192	802	838
NHA MBS for institutional investors	470	339	1,333	737
NHA MBS/CMB/ABCP securitization	911	856	4,373	3,135
Internal Company resources	93	118	419	353
Total	$ 3,383	$ 2,751	$ 14,058	$ 13,989
Mortgages under administration				
Single-family residential	$ 57,652	$ 49,636	$ 57,652	$ 49,636
Multi-unit residential and commercial	17,967	17,624	17,967	17,624
Total	$ 75,619	$ 67,260	$ 75,619	$ 67,260

Total mortgage origination volumes increased in 2013 by less than 1% as the single-family housing market bounced back from a slow start in the first quarter of 2013. Management believes this is partially a result of the cyclical slowdown in the housing market along with measures introduced by the federal government in June 2012 to reduce the amount homeowners can borrow under government-backed mortgage insurance programs. Single-family volumes decreased by 3% year over year as demand for housing continued despite the government intervention. Commercial segment originations remained strong, particularly in the fourth quarter, rising by 16% compared to 2012.

The low interest rate environment which existed for most of 2012 continued for much of 2013 such that increased commercial real estate transactions, together with the Company's expertise in underwriting CMHC mortgages, drove strong origination volumes. Origination for direct securitization into NHA MBS, CMB and ABCP programs increased significantly from $3.1 billion to almost $4.4 billion as the Company took advantage of demand for government-insured securities.

For most of 2013, Canadian capital markets were relatively upbeat. The impact of an improving global economy and recovery in Canada meant a movement of capital from the bond markets, such that bond prices fell and yields increased. For the Company, this meant the value of holding short bond positions as a hedge against its mortgages pending securitization increased and the Company recorded large gains on financial instruments. Despite some negative sentiment in the third quarter of 2013, economic indicators turned favourable in the fourth quarter and bond yields rose. Accordingly, the impact in the fourth quarter on First National was positive and it realized net gains on its short bond position.

Total revenues for the year ended December 31, 2013 increased by about 24% compared to the year ended December 31, 2012, from $628.6 million to $776.5 million. This measure increased because of the favourable change in gains and losses on financial instruments between the years as well as higher interest revenue on the larger portfolio of mortgages pledged under securitization and mortgage investment income.

Net interest – securitized mortgages

Comparing the year ended December 31, 2013 to the year ended December 31, 2012, "net interest – securitized mortgages" increased by 17% to $106.0 million from $90.3 million. The increase was due to a larger portfolio of securitized mortgages offset by tighter weighted-average spreads on the portfolio year over year. The portfolio of mortgages funded through securitization increased from $13.0 billion as at December 31, 2012 to $17.7 billion as at December 31, 2013; however, the market for prime mortgages became more competitive as the Company grew this portfolio. At December 31, 2012, the Company's securitized mortgage portfolio earned gross spreads of approximately 1.04%. By December 31, 2013, as higher-spread securitizations amortized down and new securitizations were entered into at tighter spreads (particularly given the large gain on financial instruments recorded in the second quarter of 2013), the weighted-average gross spread decreased to 0.94%. Net interest is also affected by the amortization of deferred origination costs and fair value adjustments that are capitalized on these mortgages. Credit losses were minimal in the quarter as the Company's exposure to uninsured mortgages declined, particularly as the Alt-A program wound up.

Placement fees

Placement fee revenue decreased 4% to $145.4 million from $151.9 million. This decrease is due to lower volumes originated for institutional investors offset by higher per unit pricing on a portion of the Company's residential origination. Total origination volumes, which drive placement fees, consisting of mortgages originated for institutional investors together with the multi-unit residential mortgages originated for the third-party MBS program, decreased by 12% from 2012 to 2013. The Company also earned higher placement fees from mortgage renewals as it negotiated higher placement fees on renewal with its institutional investors and placed more renewal origination in 2013 as opposed to 2012.

Gains on deferred placement fees

Gains on deferred placement fees revenue increased 43% to $11.0 million from $7.7 million. The gains relate to multi-unit residential mortgages originated and sold to institutional MBS issuers. Volumes increased by 81% from $737 million in 2012 to $1.3 billion in 2013. Generally, spreads on these transactions tightened in 2013 so that the Company realized lower per unit gains.

Mortgage servicing income

Mortgage servicing income increased 3% to $92.8 million from $89.9 million. This increase was primarily due to the growth in the amount of MUA, which grew by 12% year over year. This growth rate reflects the growth of MUA for the Company's securitization programs of 36% and third-party MUA growth of 7% between 2012 and 2013. At December 31, 2013, there were approximately $18.8 billion of mortgages in MUA on which the Company earned net interest spread as opposed to servicing revenue. This has grown from $13.9 billion in 2012. As the securitized portfolio has grown and become a larger part of MUA, mortgage servicing has been sacrificed for wider spreads as recorded in "net interest – securitized mortgages" revenue. The Company's average rate of servicing has also dropped as volume discount thresholds for some residential investors have been reached.

Mortgage investment income

Mortgage investment income increased 51% to $54.2 million from $35.9 million. The change is largely due to the Company's larger securitization program. As the Company elects to securitize more of its origination, mortgages accumulated for securitization increase and earn the Company higher interest income in the warehousing period prior to securitization. This is particularly true for the CMB program, for which the warehousing period is as long as four months. The remaining change is a combination of offsetting factors, including about $4.8 million of mortgage interest earned on consolidation of $69 million of mortgages held through the Fund.

Realized and unrealized gains (losses) on financial instruments

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

Summary of realized and unrealized gains (losses) on financial instruments

($000s)

	Quarter ended		Year ended	
	December 31 2013	**December 31 2012**	**December 31 2013**	**December 31 2012**
Gains (losses) on short bonds used for the economic hedging program	$ 3,945	$ 915	$ 28,668	$ (1,644)
Gains related to the mortgages designated at fair value net of interest rate swaps	1,618	4,871	15,141	8,277
Gains (losses) on deferred placement fees receivable	65	32	(297)	(131)
Losses on mortgage and loan investments	–	(457)	–	(521)
Other gains	110	71	354	172
Total gains on financial instruments	$ 5,738	$ 5,432	$ 43,866	$ 6,153

The Company uses short Government of Canada bonds (including CHT-issued bonds) together with repurchase agreements to create forward interest rate contracts to hedge the interest rate risk associated with fixed rate mortgages originated for its own securitization programs. For accounting purposes, these do not qualify as valid interest rate hedges as the bonds used are not derivatives but simple cash-based financial instruments. Under IFRS, these gains or losses are recorded in the period in which the bond yields change; however, the offsetting economic gains or losses are not recorded in the same period. Instead, the resulting economic gain (or loss) will be reflected in wider or narrower spreads on the mortgages pledged for securitization and will be realized in net interest margin over the terms of the mortgages and the related debts. In 2013, the Company recorded gains on these hedges of $28.7 million (2012 – losses of $1.6 million). The 2013 gains are the result of an environment of generally rising bond yields experienced during the year. While these gains increased the current year's net income, the gross spread on the related portfolio of securitized mortgages going forward will be proportionally tighter as the Company has issued securitization-related debt at higher interest rates than it would have prior to the movement in bond yields.

Economic sentiment about the global economy fluctuated during the year but generally opening optimism prevailed and led to quickly rising bond yields peaking in the third quarter. The fourth quarter was more sedate as deflationary issues led to some of the previous increases being given back, but bond yields crept up late in the quarter to favourably impact the Company's short bond positions. Overall, five-year Government of Canada bond yields increased from approximately 1.45% at the beginning of the year to 1.95% at year end. Because of this significant movement, the Company's gain was large. The large gain was also a function of the size of its warehouse of mortgages awaiting securitization and the timing of hedging transactions within each quarter. In order to adequately hedge its interest rate exposure, the Company had more than $800 million of bonds sold short at the end of the year. The portion of the Company's mortgages which is held at fair value (primarily those funded through ABCP), was affected negatively by the change in yields; however, these losses were more than offset by gains on the value of the interest rate swaps, which were used to hedge all fixed rate mortgages in this portfolio. The mortgages were favourably affected by lower rates of prepayment and the tightening of mortgage funding spreads experienced within the year, which made existing mortgages comparatively more valuable. The Company also leveraged on mortgages, which it renewed for additional five-year terms and measured at fair value. Those renewals created immediate gains for the Company, as renewed mortgages typically do not require the payment of an upfront brokerage fee. The net fair value of the gains and losses on this portfolio of mortgages was a $15.1 million gain for the year.

Brokerage fees expense

Brokerage fees expense decreased 27% to $84.4 million from $116.0 million. This decrease is largely explained by lower origination of single-family mortgages for institutional investors, which fell by 20%. The decrease of broker fees in excess of the change in origination is largely explained by lower per unit fees, volume discounts for electronic delivery services associated with brokerage, and lower commercial brokerage fees than recorded in 2012.

Salaries and benefits expense

Salaries and benefits expense increased 10% to $62.0 million from $56.3 million. The increase is due primarily to an increase in headcount and higher employee costs associated with commercial segment origination. The Company compensates its commercial sales staff with commissions based on the profitability of originated mortgages. Commercial origination increased by 16% from 2012 to 2013, and sales compensation increased by $1.6 million year over year. As at December 31, 2013, the Company had 663 employees, compared to 615 as at December 31, 2012. The 8% increase in headcount is largely to meet the administrative demand associated with the increased MUA, which increased by 12% year over year. Management salaries were paid to the two senior executives (Co-founders) who indirectly each own about 40% of the Company's common shares. The current period expense is a result of the compensation arrangement executed on the closing of the initial public offering ("IPO").

Interest expense

Interest expense increased 47% to $29.2 million from $19.8 million. As discussed in the "Liquidity and Capital Resources" section of this analysis, the Company warehouses a portion of the mortgages it originates prior to settlement with the ultimate investor or funding with a securitization vehicle. The Company uses the debenture together with a $570 million credit facility with a syndicate of banks and 30-day repurchase facilities to fund the mortgages during this period. The overall interest expense has increased from the prior period due to increased use of the credit facility and repurchase facilities to warehouse the larger amounts of mortgages originated for the Company's securitization programs. As at December 31, 2013, the Company had borrowed $884 million using these facilities, compared to $656 million as at December 31, 2012. Generally, interest expense would have been higher but for the increased use of 30-day repurchase facilities instead of bank debt.

Other operating and amortization of intangibles expenses

Other operating and amortization of intangibles expenses increased 13% to $44.1 million from $38.9 million. The amortization of intangible assets recognized on the IPO was $5.6 million in 2013 compared to $6.5 million in 2012, as some of these assets became fully amortized in 2013. Other operating expenses increased by $3.8 million as the Company incurred higher costs related to its increased securitization program, including costs for hedging, which increased $1.5 million year over year. The increase also includes $1.4 million of operating expenses related to the Fund (which the Company now consolidates into its earnings).

Non-controlling interests

This amount relates to the amount of the net income earned from the Fund that pertains to interests other than the Company. The first quarter of 2013 was the first period in which the Company consolidated the operations of the Fund. The amount has increased during 2013 as the Fund's operations became more profitable as it levered up its operations to maximize capital efficiency.

Income before income taxes and Pre-FMV EBITDA

Income before income taxes increased 55% to $233.5 million from $150.8 million. The increase was partially the result of a rising interest rate environment, which positively affected the Company's interest rate hedges in 2013. Income before income taxes was comparatively higher in 2013 by $37.7 million due to the change in gains and losses on financial instruments. Pre-FMV EBITDA, which eliminates the impact of the gains and losses on financial instruments, increased 29% to $197.6 million from $153.2 million. The increase was largely due to the combination of higher net interest on securitized mortgages and increased placement fees net of broker fees. Together these provided the Company with $40.8 million of additional pre-tax profit.

Provision for income taxes

The provision for taxes increased 52% to $61.4 million from $40.5 million. The provision is higher due to the increased earnings recorded in 2013 compared to those in 2012.

Operating Segment Review

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

Operating business segments

($000s except percent amounts)

	Residential		Commercial	
Quarter ended	**December 31 2013**	**December 31 2012**	**December 31 2013**	**December 31 2012**
Originations	$ 10,925,390	$ 11,280,166	$ 3,133,273	$ 2,709,213
Percentage change	(3.1%)		15.7%	
Revenue	$ 590,976	$ 465,593	$ 185,532	$ 163,020
Percentage change	26.9%		13.8%	
Income before income taxes	$ 175,049	$ 107,650	$ 58,462	$ 43,175
Percentage change	62.6%		35.4%	
Year ended	**December 31 2013**	**December 31 2012**	**December 31 2013**	**December 31 2012**
Identifiable assets	$ 16,282,131	$ 11,426,562	$ 4,257,310	$ 3,595,745
Mortgages under administration	$ 57,652,258	$ 49,636,195	$ 17,966,745	$ 17,623,891

Residential Segment

Although residential origination decreased by 3% between 2013 and 2012, residential revenues increased by about 27%. Part of the increase is due to the change in gains and losses on financial instruments. Excluding these changes, revenue increased by 21% as both MUA and the securitized mortgage portfolio grew and produced higher revenue. Net changes of gains on financial instruments of $29.4 million also affected net income before income taxes, as well as revenues. Without the impact of such fair value changes, net income before income taxes for the residential segment would have grown by 37% year over year, indicative of MUA growth of 16% and higher net margins on placement fees and securitized mortgages. Identifiable assets have increased since December 31, 2012, as the Company added more than $4.1 billion of net single-family mortgages to mortgages pledged under securitization, and almost $500 million of government bonds purchased for hedging purposes.

Commercial Segment

Commercial revenues increased by almost 14% from the prior year, in line with a 16% increase in origination volume. Like the residential segment, commercial revenues were affected by changes in fair value. The increase in gains on financial instruments of $8.3 million increased revenue by 5%. Without these movements, commercial segment revenues grew by 9%. This slower growth is due to tighter margins on placement and deferred placement as the multi-unit residential mortgage market became more competitive. Without fair value amounts, net income before tax increased by about $7.0 million year over year, or an increase of 17%, as increased net interest on securitized mortgages and mortgage investment income flowed through to the bottom line. Identifiable assets have increased from those at December 31, 2012, as the Company increased its securitized portfolio of multi-unit residential mortgages through NHA MBS by more than $500 million and added almost $150 million of government bonds purchased for hedging purposes.

Liquidity and Capital Resources

The Company's fundamental liquidity strategy has been to invest in prime Canadian mortgages. Management's belief has always been that these mortgages are considered "AAA" by investors and will always be well bid and highly liquid. This strategy proved effective during the turmoil experienced in 2007 through 2009, when capital markets retreated and only the highest-quality assets were bid. As the Company's results in those years have shown, First National had little, if any, trouble finding investors to purchase its mortgage origination at profitable margins. Originating prime mortgages also allows the Company to securitize in the capital markets; however, this activity requires significant cash resources to purchase and hold mortgages prior to arranging for term debt through the securitization markets. For this purpose, the Company uses the combination of the $175 million debenture loan and the Company's revolving bank credit facility. This aggregate indebtedness is typically used to fund: (1) mortgages accumulated for sale or securitization, (2) deferred placement fees receivable, (3) the origination costs associated with securitization, and (4) mortgage and loan investments. The Company has a credit facility with a syndicate of eight financial institutions for a total credit of $570 million. This facility was closed in December 2012 for a four-year term. Bank indebtedness may also include borrowings obtained through overdraft facilities. At December 31, 2013, the Company has entered into repurchase transactions with financial institutions to borrow $609 million related to $620 million of mortgages held in "mortgages accumulated for sale or securitization" on the balance sheet.

At December 31, 2013, outstanding bank indebtedness (excluding bank indebtedness at the Fund level) was $260.3 million (December 31, 2012 – $185.0 million). Together with the debenture financing of $175 million (December 31, 2012 – $175 million), this "combined debt" was used to fund $454.8 million (December 31, 2012 – $297.2 million) of mortgages accumulated for sale or securitization. At December 31, 2013, the Company's other interest-yielding assets included: (1) deferred placement fees receivable of $33.6 million (December 31, 2012 – $41.9 million) and (2) mortgage and loan investments of $184.6 million (December 31, 2012 – $173.0 million). The difference between "combined debt" and the mortgages accumulated for sale or securitization funded by it, which the Company considers a proxy for true leverage, has decreased between December 31, 2012 and December 31, 2013, and now stands at $nil (December 31, 2012 – $62.8 million). Effectively, the Company's bank, debenture and repo debt have been used entirely to fund mortgages accumulated for sale or securitization such that there is no debt needed to fund any other part of the Company's operations. This debt-to-equity ratio has decreased from 0.19 to 1 as at December 31, 2012 as the Company has repaid bank debt fully with the proceeds from the repayment of approximately $44.7 million of cash held as collateral under securitization together with cash from operations.

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

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

A portion of the Company's capital has been employed to support its ABCP and NHA MBS programs, primarily to provide credit enhancements as required by rating agencies. In June 2011, CMHC issued new regulations regarding the timing of mortgage title transfer to its custodian. The notice requires that cash collateral be posted immediately on pool settlement with the custodian on a dollar-for-dollar basis for all mortgages not registered with the custodian. Due to the difficulty in obtaining evidence from land registry offices on a timely basis, the Company has been required to post cash collateral for the pending title transfers. At December 31, 2013, $4.8 million (December 31, 2012 – $37.7 million) of this collateral was held by the custodian. The collateral will be repaid to the Company as registration is subsequently evidenced to the custodian on these mortgages. The other significant portion of cash collateral is the investment made on behalf of the Company's ABCP programs. As at December 31, 2013, the investment in cash collateral was $20.0 million (December 31, 2012 – $28.0 million). In 2012, this total included $11.9 million for the Alt-A program. In October 2013, the Company terminated the Alt-A program, repaying $13.6 million of debt related to securitized mortgages and receiving a repayment of the $11.9 million of cash collateral. The Company will fund the remaining portfolio of Alt-A mortgages from the program with internal resources. The Company continues to employ an assumption for the fair value of credit losses in the Alt-A program. To date, this assumption has been adequate to absorb all actual losses experienced in the program.

As demonstrated previously, the Company continues to see strong demand for its mortgage product from institutional investors and liquidity from bank-sponsored commercial paper conduits. By focusing on the prime mortgage market, the Company believes it will continue to attract bids for mortgages as its institutional customers seek government-insured assets for investment purposes. The Company also believes it can manage any liquidity issues that would arise from a year-long slowdown in origination volumes. Based on cash flow received in the fourth quarter of 2013, the Company will receive approximately $76 million of cash, on an annualized basis, from its servicing operations and $120 million of annualized cash flow from securitization transaction spread and deferred placement fees receivables. Together, on an after-tax basis, this $144 million of annual cash flow would be more than sufficient to support the annual dividends of $90 million on the common shares and the $4.65 million on the preference shares. Although this is a simplified analysis, it does highlight the sustainability of the Company's business model and dividend policy through periods of economic weakness.

As described earlier, the Company issued 4,000,000 Class A preference shares, Series 1, at a price of $25.00 per share for gross proceeds of $100 million, before issue expenses. The net proceeds of $96.7 million were invested in FNFLP as partners' capital. The issuance gives the Company additional capital, which will allow it to undertake greater volumes of securitization transactions directly and reduce reliance on institutional investors as a funding source.

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

Financial Instruments and Risk Management

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

The Company believes its hedging policies are suitably disciplined such that the interest rate risk of holding mortgages prior to securitization is mitigated. From an accounting perspective, any gains or losses on these instruments are recorded in the current period, as the Company's economic hedging strategy does not qualify as hedging for accounting purposes. The Company uses bond forwards (consisting of bonds sold short and bonds purchased under resale agreements) to manage interest rate exposure between the time a mortgage rate is committed to the borrower and the time the mortgage is transferred to the securitization vehicle and the matched term debt is arranged. As interest rates change, the value of these short bonds will vary inversely with the value of the related mortgages. As interest rates increase, a gain will be recorded on the bonds, which should be offset by a tighter interest rate spread between the interest rates on mortgages and the securitization debt. This spread will be earned over the term of the related mortgages. For single-family mortgages, primarily mortgages for the Company's own securitization programs, only some of the mortgage commitments issued by the Company eventually fund. The Company must assign a probability of funding to each mortgage in the pipeline and estimate how that probability changes as mortgages move through the various stages of the pipeline. The amount that is actually hedged is the expected value of mortgages funding within the next 120 days (120 days being the standard maximum rate hold period available for the mortgages). As at December 31, 2013, the Company has $697.1 million of notional forward bond positions related to its single-family programs. For multi-unit residential and commercial mortgages, the Company assumes all mortgages committed will fund and hedges each mortgage individually. This includes mortgages committed for the CMB program as well as mortgages for transfer to the Company's other securitization vehicles. As at December 31, 2013, the Company had entered into $106.4 million in notional value forward bond sales for this segment. The total net value of realized and unrealized gains and losses on account of all notional hedges pertaining to the period January 1, 2013 to December 31, 2013 was a $28.7 million gain. This amount has been included in revenue in the statement of comprehensive income.

Upon settlement of the debenture issuance, the Company entered into a float-for-fix swap. The swap requires the Company to pay CDOR+2.134% on a notional amount of $175 million and to receive the debenture interest coupon (5.07%) semi-annually. This effectively converts the fixed rate semi-annual debenture-based loan payable into a floating rate monthly resetting note payable. Since the date when this swap was entered into, five-year interest rates have decreased pursuant to global economic issues and the value of this swap has increased to $4.2 million as at December 31, 2013. The Company has documented this swap as a hedge for accounting purposes, as the fixed leg of the swap exactly matches the cash flow obligations under the debenture. Effectively, the unrealized gain of $4.2 million on the swap has been excluded from earnings and been applied to increase the carrying value of the debenture note payable. The Company is also a party to three amortizing fix-for-float rate swaps that economically hedge the interest rate exposure related to certain mortgages held on the balance sheet that the Company has originated as replacement assets for its CMB activities. As at December 31, 2013, the aggregate notional value of these swaps was $37.6 million. During the year the value of these swaps increased by about $0.4 million. The amortizing swaps mature between July 2015 and June 2021.

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

The same exposure to risk is inherent in the Company's securitization through ABCP. The Company is exposed to the risk that 30-day ABCP rates are greater than 30-day BA rates. Prior to the financial crisis, the Company considered this a low risk given the quality of the assets securitized, the amount of credit enhancements provided by the

Company and the strong covenant of the bank-sponsored conduits with which the Company transacted. In 2008, 30-day ABCP traded at approximately 1.10 percentage points over BAs; but by the end of March 2011, it was priced at a discount to BAs. At the same time the Company has leveraged on changing credit spreads. The success of this approach has been demonstrated through the increase in volume and profitability of the NHA MBS program and significant increases in gains on deferred placement fees from the sale of prime insured mortgages. As at December 31, 2013, the Company has various exposures to changing credit spreads. In particular, in mortgages accumulated for sale or securitization, there are over $1 billion of mortgages that are susceptible to some degree of changing credit spreads.

Capital Expenditures

A significant portion of First National's business model consists of the origination and placement or securitization of financial assets. Generally, placement activities do not require much capital investment as the Company acts primarily in the capacity of a broker. On the other hand, the undertaking of securitization transactions may require significant amounts of the Company's own capital. This capital is provided in the form of cash collateral, credit enhancements, and the upfront funding of broker fees and other origination costs. These are described more fully in the "Liquidity and Capital Resources" section above. For fixed assets, the business requires capital expenditures on technology (both software and hardware), leasehold improvements and office furniture. During the year ended December 31, 2013, the Company purchased new computers and office and communications equipment primarily to support its single-family residential business. Going forward, the Company expects capital expenditures on fixed assets will be approximately $3.0 million annually.

Summary of Contractual Obligations

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

($000s)	**Payments due by period**				
	Total	**0–1 year**	**2–3 years**	**4–5 years**	**After 5 years**
Lease obligations	$ 25,945	$ 5,150	$ 10,253	$ 9,065	$ 1,477
Total contractual obligations	$ 25,945	$ 5,150	$ 10,253	$ 9,065	$ 1,477

Critical Accounting Policies and Estimates

The Company prepares its financial statements in accordance with IFRS, which requires management to make estimates, judgments and assumptions that management believes are reasonable based upon the information available. These estimates, judgments and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Management bases its estimates on historical experience and other assumptions that it believes to be reasonable under the circumstances. Management also evaluates its estimates on an ongoing basis. The significant accounting policies of First National are described in Note 2 to the Company's audited financial statements as at December 31, 2013. The Company adopted IFRS 10, 12 and 13 in the first quarter of 2013, as described in the notes to the financial statements. The policies which First National believes are the most critical to aid in fully understanding and evaluating its reported financial results include the determination of the gains on deferred placement fees and the impact of fair value accounting on financial instruments.

The Company uses estimates in valuing its gain or loss on the sale of its mortgages placed with institutions earning a deferred placement fee. Under IFRS, valuing a gain on deferred placement requires the use of estimates to determine the fair value of the retained interest (derived from the present value of expected future cash flows) in the mortgages. These retained interests are reflected on the Company's balance sheet as deferred placement fees receivable. The key assumptions used in the valuation of gains on deferred placement fees are prepayment rates and the discount rate used to present value future expected cash flows. The annual rate of unscheduled principal payments is determined by reviewing portfolio prepayment experience on a monthly basis. The Company uses different rates for its various programs, which average approximately 15% for single-family mortgages. The Company assumes there is virtually no prepayment on multi-unit residential fixed rate mortgages.

On a quarterly basis, the Company reviews the estimates used to ensure their appropriateness and monitors the performance statistics of the relevant mortgage portfolios to adjust and improve these estimates. The estimates used reflect the expected performance of the mortgage portfolio over the lives of the mortgages. The assumptions underlying the estimates used for the year ended December 31, 2013 continue to be consistent with those used for the year ended December 31, 2012 and the quarters ended September 30, 2013, June 30, 2013 and March 31, 2013.

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

Future Accounting Changes

The Company adopted IFRS as at January 1, 2010. The following new IFRS pronouncements have been issued and, although not yet effective, may have a future impact on the Company.

The Company will be required to adopt IFRS 9, *Financial Instruments* ("IFRS 9"), which is the first phase of the IASB's project to replace IAS 39. On November 19, 2013, the IASB decided that the previously set mandatory effective date of January 1, 2015 would not allow sufficient time for entities to prepare to apply IFRS 9, and that a new date should be determined when IFRS 9 is closer to completion, currently expected to be January 1, 2018. IFRS 9 will provide new requirements for the way in which an entity should classify and measure financial assets and liabilities that are in the scope of IAS 39, with a final standard targeted in the first half of 2014. The standard requires all financial assets to be classified on the basis of the entity's business model for managing such financial assets and the contractual cash flow characteristics of the financial assets. On November 19, 2013, the IASB introduced a new hedge accounting model. The general hedge accounting standard is intended to provide better links between an entity's risk management activities, the rationale for hedging and the impact of hedging on the financial statements. The impairment phase of the IASB's financial instruments project is currently under development, with a review draft of the standard issued in March 2013 and a final standard targeted in the first half of 2014. Management is currently evaluating the potential impact that the adoption of IFRS 9 will have on the Company's consolidated financial statements.

Disclosure Controls and Internal Controls over Financial Reporting

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

As of December 31, 2013, management evaluated, under the supervision of and with the participation of the Chief Executive Officer and Chief Financial Officer, the effectiveness of the Company's disclosure controls and procedures. Based on this evaluation, management concluded that the Company's disclosure controls and procedures, as defined by National Instrument 52-109, *Certification of Disclosure in Issuers' Annual and Interim Filings*, were effective as of December 31, 2013.

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

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

Risks and Uncertainties Affecting the Business

The business, financial condition and results of operations of the Company are subject to a number of risks and uncertainties, and are affected by a number of factors outside the control of management of the Company, including: ability to sustain performance and growth, reliance on sources of funding, concentration of institutional investors, reliance on independent mortgage brokers, changes in interest rates, repurchase obligations and breach of representations and warranties on mortgage sales, risk of servicer termination events and trigger events on cash collateral and retained interests, reliance on multi-unit residential and commercial mortgages, general economic conditions, government regulation (including the policies set for mortgage default insurance companies), competition, reliance on mortgage insurers, reliance on key personnel, conduct and compensation of independent mortgage brokers, failure or unavailability of computer and data processing systems and software, insufficient insurance coverage, change in or loss of ratings, impact of natural disasters and other events, environmental liability and risk related to Alt-A mortgages, which experience higher arrears rates and credit losses than prime mortgages. In addition, risks associated with the structure of the Company include those related to the dependence on FNFLP, leverage and restrictive covenants, dividends which are not guaranteed and could fluctuate with FNFLP's performance, restrictions on potential growth, the market price of the Company's shares, statutory remedies, control of the Company and contractual restrictions, and income tax matters. Risk and risk exposure are managed through a combination of insurance, a system of internal controls and sound operating practices. The Company's key business model is to originate primarily prime mortgages and find funding through various channels to earn ongoing servicing or spread income. For the single-family residential segment, the Company relies on independent mortgage brokers for origination and several large institutional investors for sources of funding. These relationships are critical to the Company's success. For a more complete discussion of the risks affecting the Company, reference should be made to the Company's Annual Information Form.

Forward-Looking Information

Forward-looking information is included in this MD&A. In some cases, forward-looking information can be identified by the use of terms such as "may", "will", "should", "expect", "plan", "anticipate", "believe", "intend", "estimate", "predict", "potential", "continue" or other similar expressions concerning matters that are not historical facts. Forward-looking information may relate to management's future outlook and anticipated events or results, and may include statements or information regarding the future financial position, business strategy and strategic goals, product development activities, projected costs and capital expenditures, financial results, risk management strategies, hedging activities, geographic expansion, licensing plans, taxes and other plans and objectives of or involving the Company. Particularly, information regarding growth objectives, any increase in mortgages under administration, future use of securitization vehicles, industry trends and future revenues is forward-looking information. Forward-looking information is based on certain factors and assumptions regarding, among other things, interest rate changes and responses to such changes, the demand for institutionally placed and securitized mortgages, the status of the applicable regulatory regime, and the use of mortgage brokers for single-family residential mortgages. This forward-looking information should not be read as providing guarantees of future performance or results, and will not necessarily be an accurate indication of whether or not, or the times by which, those results will be achieved. While management considers these assumptions to be reasonable based on information currently available to it, they may prove to be incorrect. Forward-looking information is subject to certain factors, including risks and uncertainties, which could cause actual results to differ materially from what management currently expects. These factors include reliance on sources of funding, concentration of institutional investors, reliance on independent mortgage brokers, and changes in interest rates as outlined under "Risk and Uncertainties Affecting the Business". In evaluating this information, the reader should specifically consider various factors, including the risks outlined under "Risk and Uncertainties Affecting the Business", which may cause actual events or results to differ materially from any forward-looking information. The forward-looking information contained in this discussion represents management's expectations as of February 25, 2014, and is subject to change after such date. However, management and the Company disclaim any intention or obligation to update or revise any forward-looking information, whether as a result of new information, future events or otherwise, except as required under applicable securities regulations.

Outlook

Management considers fiscal 2013 to have been very successful. Despite opening headwinds in the first quarter and the initiation of new government controls designed to moderate consumer borrowing, the Company originated almost $11 billion of single-family residential mortgages. The Company was able to increase origination in the commercial segment by 16%, and together set a new record for total origination of $14.1 billion. The Company took advantage of its renewal opportunities and demand from the capital markets to successfully securitize approximately $4.4 billion of mortgages.

For 2014, the Company anticipates the low interest rate environment will continue with moderated, but still healthy, mortgage spreads. Management foresees similar origination volumes in 2014 as recorded in 2013. By realizing on the significant renewal opportunities available in the year and focusing on its partnerships with institutional customers, the Company expects to fund almost $20 billion of mortgages in 2014. Despite flat origination targets, management expects to continue to capitalize on higher volumes of mortgage renewals and to generate cash flow from its almost $18 billion portfolio of mortgages pledged under securitization in order to maximize the Company's financial performance.

Management's Responsibility for Financial Reporting

The management of First National Financial Corporation (the "Company") is responsible for the preparation and fair presentation of the accompanying annual consolidated financial statements and Management's Discussion and Analysis ("MD&A"). The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS").

The consolidated financial statements and information in the MD&A necessarily include amounts based on the best estimates and judgments by management of the expected effects of current events and transactions with the appropriate consideration to materiality. In addition, in preparing this financial information the Company must make determinations about the relevancy of information to be included, and estimates and assumptions that affect the reported information. The MD&A also includes information regarding the impact of current transactions and events, sources of liquidity and capital resources, operating trends, risks and uncertainties. Actual results in the future may differ materially from our present assessment of this information because future events and circumstances may not occur as expected.

In meeting our responsibility for the integrity and fairness of the annual consolidated financial statements and MD&A and for the accounting systems from which they are derived, management has established the necessary internal controls designed to ensure that the Company's financial records are reliable for preparing financial statements and other financial information, transactions are properly authorized and recorded, and assets are safeguarded against unauthorized use or disposition.

As at December 31, 2013, the Chairman, President and Chief Executive Officer and Chief Financial Officer evaluated, or caused an evaluation under their direct supervision, of the design and operation of our internal controls over financial reporting (as defined in National Instrument 52-109 – *Certificate of Disclosure in Issuers' Annual and Interim Filings*) and, based on that assessment, determined that the Company's internal controls over financial reporting were appropriately designed and operating effectively.

The Board of Directors oversees management's responsibility for financial reporting through an Audit Committee, which is composed entirely of independent directors. This committee reviews the Company's annual consolidated financial statements and MD&A with both management and the independent auditors before such statements are approved by the Board of Directors. Other key responsibilities of the Audit Committee include selecting the Company's auditors, approving the Company's interim unaudited condensed consolidated financial statements and MD&A, and monitoring the Company's existing systems of internal controls.

Ernst & Young LLP, independent auditors appointed by the shareholders of First National Financial Corporation upon the recommendation of the Board of Directors, have examined the Company's 2013 and 2012 annual consolidated financial statements and have expressed their opinion upon the completion of such examination in the following report to the shareholders. The auditors have full and free access to, and meet at least quarterly with, the Audit Committee to discuss their audit and related matters.

Stephen Smith

Stephen J. R. Smith
Chairman, President and
Chief Executive Officer

Robert A. Inglis
Chief Financial Officer

Toronto, Canada
February 25, 2014

Independent Auditors' Report

To the shareholders of First National Financial Corporation

We have audited the accompanying consolidated financial statements of First National Financial Corporation, which comprise the consolidated statements of financial position as at December 31, 2013 and 2012, and the consolidated statements of comprehensive income, changes in equity and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

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

Auditors' responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in a ccordance 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 consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of First National Financial Corporation as at December 31, 2013 and 2012, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Ernst & Young LLP

Chartered Accountants
Licensed Public Accountants

Toronto, Canada
February 25, 2014

Consolidated Statements of Financial Position

($000s)

As at December 31	Notes	2013	2012
			(Restated – note 24)
ASSETS			
Restricted cash	3	$ 431,111	$ 334,962
Accounts receivable and sundry		60,110	51,302
Securities purchased under resale agreements and owned	15	1,055,443	452,534
Mortgages accumulated for sale or securitization	5	1,074,825	808,522
Mortgages pledged under securitization	3	17,651,644	13,032,043
Deferred placement fees receivable	4	33,580	41,919
Cash held as collateral for securitization	3	24,804	69,493
Purchased mortgage servicing rights	8	3,079	3,881
Mortgage and loan investments	6	184,584	173,034
Other assets	7	50,037	54,546
Total assets		$ 20,569,217	$ 15,022,236
LIABILITIES AND EQUITY			
Liabilities			
Bank indebtedness	10	$ 274,484	$ 155,197
Obligations related to securities and mortgages sold under repurchase agreements	16	609,292	500,608
Accounts payable and accrued liabilities		66,426	60,381
Securities sold under repurchase agreements and sold short	15	1,050,199	451,875
Debt related to securitized and participation mortgages	11	17,884,303	13,272,810
Debenture loan payable	13	179,195	181,275
Income taxes payable	18	4,207	1,790
Deferred tax liabilities	18	51,200	32,900
Total liabilities		$ 20,119,306	$ 14,656,836
Equity attributable to shareholders			
Common shares	17	$ 122,671	$ 122,671
Preferred shares	17	97,394	97,394
Retained earnings		184,561	102,440
		404,626	322,505
Non-controlling interests		45,285	42,895
Total equity		449,911	365,400
Total liabilities and equity		$ 20,569,217	$ 15,022,236

See accompanying notes

On behalf of the Board:

John Brough

Robert Mitchell

Consolidated Statements of Comprehensive Income

($000s, except earnings per unit)

Years ended December 31	Notes	2013	2012
REVENUE			
Interest revenue – securitized mortgages		$ 429,223	$ 336,987
Interest expense – securitized mortgages		(323,236)	(246,736)
Net interest – securitized mortgages	3	105,987	90,251
Placement fees		145,407	151,919
Gains on deferred placement fees	4	11,021	7,705
Mortgage investment income		54,166	35,934
Mortgage servicing income		92,825	89,915
Realized and unrealized gains on financial instruments		43,866	6,153
		453,272	381,877
EXPENSES			
Brokerage fees		84,420	115,978
Salaries and benefits		62,029	56,299
Interest		29,170	19,829
Other operating		38,579	32,478
Amortization of intangible assets		5,563	6,468
		219,761	231,052
Income before income taxes		233,511	150,825
Income tax	18	61,410	40,500
Net income and comprehensive income for the year		172,101	110,325
Net income attributable to:			
Shareholders		169,726	110,325
Non-controlling interests		2,375	–
		$ 172,101	$ 110,325
Earnings per share			
Basic	17	$ 2.75	$ 1.76

See accompanying notes

Consolidated Statements of Changes in Equity

($000s)

	Common shares	Preferred shares	Retained earnings	Non-controlling interests	Total equity
Balance at January 1, 2013	$ 122,671	$ 97,394	$ 102,440	$ 42,895	$ 365,400
Comprehensive income	–	–	169,726	2,375	172,101
Dividends paid or declared	–	–	(87,605)	(2,689)	(90,294)
Non-controlling interests	–	–	–	2,704	2,704
Balance at December 31, 2013	$ 122,671	$ 97,394	$ 184,561	$ 45,285	$ 449,911
				(Restated – note 24)	
Balance at January 1, 2012	$ 122,671	$ 97,394	$ 72,974	$ –	$ 293,039
Comprehensive income	–	–	110,325	–	110,325
Dividends paid or declared	–	–	(80,859)	–	(80,859)
Initial recognition of non-controlling interests	–	–	–	42,895	42,895
Balance at December 31, 2012	$ 122,671	$ 97,394	$ 102,440	$ 42,895	$ 365,400

See accompanying notes

Consolidated Statements of Cash Flows

($000s)

Years ended December 31	2013	2012
		(Restated – note 24)
OPERATING ACTIVITIES		
Net income for the year	$ 172,101	$ 110,325
Add (deduct) items not affecting cash:		
Deferred income tax expense	18,300	2,600
Non-cash portion of gains on deferred placement fees	(9,912)	(5,976)
Increase in restricted cash	(96,149)	(91,278)
Net investment in mortgages pledged under securitization	(4,600,694)	(3,260,336)
Net increase in debt related to securitized mortgages	4,630,915	3,353,695
Amortization of deferred placement fees receivable	17,955	22,363
Amortization of purchased mortgage servicing rights	802	890
Amortization of property, plant and equipment	2,374	2,059
Amortization of intangible assets	5,563	6,468
Unrealized gains on financial instruments	(19,286)	(16,755)
	121,969	124,055
Net change in non-cash working capital balances related to operations	(272,641)	42,542
Cash provided by (used in) operating activities	$ (150,672)	$ 166,597
INVESTING ACTIVITIES		
Additions to property, plant and equipment	(3,428)	(2,955)
Investment in cash held as collateral for securitization	44,689	(12,611)
Investment in mortgage and loan investments	(142,353)	(176,064)
Repayment of mortgage and loan investments	130,803	183,452
Cash provided by (used in) investing activities	$ 29,711	$ (8,178)
FINANCING ACTIVITIES		
Dividends paid	$ (87,106)	$ (80,609)
Obligations related to securities and mortgages sold under repurchase agreements	108,684	(163,816)
Debt related to participation mortgages	(19,422)	(38,104)
Securities purchased under resale agreements and owned, net	(602,909)	205,092
Securities sold under repurchase agreements and sold short, net	602,412	(198,466)
Non-controlling interest	15	42,895
Cash provided by (used in) financing activities	$ 1,674	$ (233,008)
Net increase in bank indebtedness during the year	(119,287)	(74,589)
Bank indebtedness, beginning of year	(155,197)	(80,608)
Bank indebtedness, end of year	$ (274,484)	$ (155,197)
Supplemental cash flow information		
Interest received	$ 536,524	$ 398,094
Interest paid	335,516	260,246
Income taxes paid	40,693	32,554

See accompanying notes

December 31, 2013 and 2012
($000s, except per unit amounts or unless otherwise noted)

Note 1
General Organization and Business of First National Financial Corporation

First National Financial Corporation (the "Corporation" or "Company") is the parent company of First National Financial LP ("FNFLP"), a Canadian-based originator, underwriter and servicer of predominantly prime residential (single-family and multi-unit) and commercial mortgages. With over $75 billion in mortgages under administration, FNFLP is an originator and underwriter of mortgages and a significant participant in the mortgage broker distribution channel.

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

Note 2
Significant Accounting Policies

2.1 Basis of preparation

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). The consolidated financial statements have been prepared on a historical cost basis, except for derivative financial instruments and financial assets and financial liabilities that are recorded at fair value through profit or loss and measured at fair value. The carrying values of recognized assets and liabilities that are hedged items in fair value hedges, and otherwise carried at amortized cost, are adjusted to record changes in fair value attributable to the risks that are being hedged. The consolidated financial statements are presented in Canadian dollars and all values are rounded to the nearest thousand except when otherwise indicated. The consolidated financial statements were authorized for issue by the Board of Directors on February 25, 2014.

2.2 Basis of consolidation

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

Effective January 1, 2013, IFRS 10 – *Consolidated Financial Statements* has replaced portions of IAS 27 – *Consolidated and Separate Financial Statements*, and interpretation SIC-12 – *Consolidation – Special Purpose Entities*. IFRS 10 requires the consolidation of an investee only if the investor possesses power over the investee, has exposure to variable returns from its investment with the investee and has the ability to use its power over the investee to affect its returns. The Company reassessed its consolidation conclusions on January 1, 2013 under IFRS 10 and determined that it controls both the Fund and the Trust, and accordingly has consolidated the operations and net assets of the Fund and Trust for the year ended December 31, 2013.

The Fund and Trust were created in 2012 as special purpose vehicles to obtain exposure to a diversified portfolio of high-yielding mortgages. The Company had accounted for the Fund and Trust using the cost method of accounting in the consolidated financial statements of the Company for the year ended December 31, 2012. With the adoption of IFRS 10 – *Consolidated Financial Statements* on January 1, 2013, the Company reassessed its consolidation conclusions and determined that it controls both the Fund and Trust. While the Company has legal ownership of approximately 16% of the units issued by the Fund, because of its status as the sole seller of assets to the Fund and its rights as promoter, the Company determined that it had de facto control of the Fund. The Company has restated the 2012 comparative information on the consolidated financial statements (note 24).

As a result of the consolidation, non controlling interests in the Fund and Trust are shown as a separate component of equity on the consolidated statements of financial position to distinguish them from the equity of the Company's shareholders. The net income attributable to non-controlling interest is also separately disclosed on the consolidated statements of comprehensive income and retained earnings.

Certain special purpose vehicles that were structured by third parties, where the Company does not have control, are not consolidated in the Company's financial statements.

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

2.3 Use of estimates

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

2.4 Significant accounting policies

Revenue recognition

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

INTEREST REVENUE AND EXPENSE FROM MORTGAGES PLEDGED UNDER SECURITIZATION

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

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

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

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

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

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

DERECOGNITION

A financial asset is derecognized when:

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

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

PLACEMENT FEES AND DEFERRED PLACEMENT FEES RECEIVABLE

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

MORTGAGE SERVICING INCOME

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

MORTGAGE INVESTMENT INCOME

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

Brokerage fees

Brokerage fees relating to the mortgages recorded at fair value are expensed as incurred. Brokerage fees relating to mortgages recorded at amortized cost are deferred and amortized over the term of the mortgages.

Mortgages pledged under securitization

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

Debt related to securitized and participation mortgages

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

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

Mortgages accumulated for sale or securitization

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

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

Securities sold short and securities purchased under resale agreements

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

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

Securities owned and securities sold under repurchase agreements

The Company purchases bonds and enters into bond repurchase agreements to close out economic hedging positions when mortgages are sold to securitization vehicles or institutional investors.

These transactions are accounted for in a similar manner as the transactions described for securities sold short and securities purchased under resale agreements.

Mortgage and loan investments

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

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

Intangible assets

Intangible assets are comprised of broker relationships and customer service contracts and arose in connection with the initial public offering ("IPO") in 2006. Intangible assets are subject to annual impairment review if there are events or changes in circumstances that indicate the carrying amount may not be recoverable.

Intangible assets with finite useful lives are amortized on a straight-line basis over their estimated useful lives as follows:

Broker relationships	Straight-line over 10 years
Investor servicing contracts	Straight-line over 5 years

Goodwill

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

Property, plant and equipment

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

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

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

Purchased mortgage servicing rights

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

Restricted cash

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

Bank indebtedness

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

Cash held as collateral under securitization

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

Income taxes

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

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

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

Earnings per common share

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

Financial assets and liabilities

The Company classifies its financial assets as either financial instruments at fair value through profit or loss or loans and receivables. Financial liabilities are classified as either held at fair value through profit or loss or at amortized cost. Management determines the classification of financial assets and liabilities at initial recognition.

FINANCIAL ASSETS AND FINANCIAL LIABILITIES HELD AT FAIR VALUE THROUGH PROFIT OR LOSS

Financial instruments are classified in this category if they are held for trading or if they are designated by management at fair value through profit or loss at inception.

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

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

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

The Company has elected to measure certain of its assets at fair value through profit or loss. The most significant of these assets include: a large portion of mortgages pledged under securitization and funded with ABCP-related debt, certain mortgages funded with MBS debt, and deferred placement fees receivable. The mortgages funded with MBS debt were previously funded by ABCP debt and as such have retained their classification as held-for-trading (together with other ABCP-funded mortgages, "HFT mortgages"). For the large portion of mortgages pledged under securitization and funded with ABCP-related debt, the Company has entered into swaps to convert the mortgages from fixed rate to floating rate in order to match the mortgages with the 30-day floating rate funding provided by the ABCP notes. The swaps are derivatives and are required by IFRS to be accounted for at fair value. This value can change significantly with the passage of time as the interest rate environment changes. In order to avoid a significant accounting mismatch, the Company has measured the swapped mortgages at fair value as well so that the asset and related liability values will move inversely as interest rates change. The cash flows related to deferred placement fees receivable are typically received over five-to-10 year terms. These cash flows are subject to prepayment volatility as the mortgages underlying the deferred placement fees receivable can experience unscheduled prepayments. As well, the Company pledges these assets under the bank credit facility. Accordingly, the Company manages these assets on a fair value basis.

Financial assets and financial liabilities held at fair value through profit or loss are initially recognized at fair value. Subsequent gains and losses arising from changes in fair value are recognized directly in the consolidated statements of comprehensive income and retained earnings.

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

LOANS AND RECEIVABLES

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

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

HELD-TO-MATURITY

Held-to-maturity assets are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Company's management has the positive intention and ability to hold to maturity. These assets are initially recognized at cost, including direct and incremental transaction costs. They are subsequently valued at amortized cost using the effective interest method.

Held-to-maturity assets can be reclassified to the available-for-sale category if the portfolio becomes tainted following the sale of other than an insignificant amount of held-to-maturity assets prior to their maturity.

Derivative financial instruments

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

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

Hedge accounting

At the inception of a hedging relationship, the Company documents the relationship between the hedging instruments and the hedged items, its risk management objective, its strategy for undertaking the hedge, and its assessment of whether or not the hedging instruments are highly effective in offsetting the changes attributable to the hedged risks in the hedged items.

For fair value hedges, changes in the fair value of derivatives that are designated and qualify as fair value hedging instruments are recorded in the consolidated statement of comprehensive income and retained earnings, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. The changes in fair value attributable to the hedged risk are accounted for as basis adjustment to the hedged item. If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used is amortized to the consolidated statement of comprehensive income and retained earnings over the period to maturity or derecognition.

NOTE 3

Mortgages Pledged under Securitization

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

As part of the ABCP transactions, the Company provides cash collateral for credit enhancement purposes as required by the rating agencies. Credit exposure to securitized mortgages is generally limited to this cash collateral. The principal and interest payments on the securitized mortgages are paid to the Company by the SPEs monthly over the term of the mortgages. The full amount of the cash collateral is recorded as an asset and the Company anticipates full recovery of these amounts. NHA MBS securitizations may also require cash collateral in some circumstances. As at December 31, 2013, the cash held as collateral for securitization was $24,804 (2012 – $69,493).

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

	2013	
	Carrying amount of securitized mortgages	**Carrying amount of associated liabilities**
Securitized mortgages at face value	$ 17,532,693	$ 17,919,788
Mark to market adjustment	37,956	–
Capitalized origination costs	80,995	–
Debt discounts	–	(47,161)
	17,651,644	17,872,627
Add:		
Principal portion of payments held in restricted cash	398,285	–
Participation debt	–	11,676
	$ 18,049,929	$ 17,884,303

	2012	
	Carrying amount of securitized mortgages	**Carrying amount of associated liabilities**
Securitized mortgages at face value	$ 12,947,870	$ 13,249,779
Mark to market adjustment	29,043	–
Capitalized origination costs	55,130	–
Debt discounts	–	(8,067)
	13,032,043	13,241,712
Add:		
Principal portion of payments held in restricted cash	311,979	–
Participation debt	–	31,098
	$ 13,344,022	$ 13,272,810

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

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

		2013		2012
Opening balance, January 1	$	55,130	$	49,782
Add: new origination costs capitalized in the year		56,542		28,809
Less: costs amortized in the year		(30,677)		(23,461)
Ending balance, December 31	$	80,995	$	55,130

During the year ended December 31, 2013, the Company advanced funds and transferred into the securitization vehicles $6,532,494 (2012 – $4,718,680) of mortgages.

As at December 31, 2013, mortgages pledged under securitization include $17,440,211 (2012 – $12,691,496) of insured mortgages and $92,482 (2012 – $256,374) of uninsured mortgages.

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

2014	$ 1,747,687
2015	2,777,610
2016	3,073,198
2017	3,696,547
2018 and thereafter	6,237,651
	17,532,693
Add:	
Capitalized origination costs	80,995
Fair value premium – HFT mortgages	37,956
	$ 17,651,644

The mortgages securitized through NHA MBS and CMB programs have been classified as loans and receivables, except for approximately $1.1 billion (2012 – $1.0 billion) of securitized mortgages included in HFT mortgages. These mortgages are carried at par plus adjustment for unamortized origination costs. Most mortgages in bank-sponsored ABCP programs have been classified as fair value through profit or loss.

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

Arrears (days)		**2013**		**2012**
31 to 60	$	71,634	$	42,185
61 to 90		15,388		13,716
Greater than 90		30,284		30,263
	$	117,306	$	86,164

Interest revenue-securitized mortgages consists of $100,160 (2012 – $82,324) of interest revenue related to ABCP-funded mortgages, which are mostly measured at fair value and $329,063 (2012 – $254,663) of interest revenue related to mortgages pledged under securitization and securitized mortgages included in HFT mortgages.

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

	2013	
	Commercial mortgages	**Residential mortgages**
HFT mortgages	$ 190,939	$ 3,097,341
Average life (in months)(1)	24	27
Prepayment speed assumption (annual rate)	8.2%	11.6%
Impact on fair value of 10% adverse change	$ 4	$ 517
Impact on fair value of 20% adverse change	$ 8	$ 1,028
Discount rate (annual rate)	2.3%	2.1%
Impact on fair value of 10% adverse change	$ 968	$ 12,156
Impact on fair value of 20% adverse change	$ 1,914	$ 24,230

	2012	
	Commercial mortgages	**Residential mortgages**
HFT mortgages	$ 418,303	$ 2,367,744
Average life (in months)(1)	18	35
Prepayment speed assumption (annual rate)	11.7%	10.9%
Impact on fair value of 10% adverse change	$ 21	$ 451
Impact on fair value of 20% adverse change	$ 42	$ 895
Discount rate (annual rate)	2.2%	2.3%
Impact on fair value of 10% adverse change	$ 1,352	$ 12,312
Impact on fair value of 20% adverse change	$ 2,682	$ 24,518

(1) The weighted-average life of prepayable assets in periods (for example, months or years) can be calculated by multiplying the principal collections expected in each future period by the number of periods until that future period, summing those products, and dividing the sum by the initial principal balance.

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

NOTE 4

Deferred Placement Fees Receivable

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

During the year ended December 31, 2013, $1,881,030 (2012 – $1,153,863) of mortgages were placed with institutional investors, which created gains on deferred placement fees of $11,021 (2012 – $7,705). Cash receipts on deferred placement fees receivable for the year ended December 31, 2013 were $18,919 (2012 – $23,695).

The Company uses various assumptions to value the deferred placement fees receivable, which are set out in the table below, including the rate of unscheduled prepayments. Accordingly, the deferred placement fees receivable are subject to measurement uncertainty. An assumption of no credit losses was used, commensurate with the credit quality of the investors. The effect of variations between actual experience and assumptions will be recorded in future statements of comprehensive income and retained earnings. Key economic weighted-average assumptions and the sensitivity of the current carrying value of residual cash flows to immediate 10% and 20% adverse changes in those assumptions are summarized as at December 31 as follows:

	2013	
	Commercial mortgages	**Residential mortgages**
Fair value of deferred placement fees receivable	$ 33,204	$ 376
Average life (in months) [1]	54	24
Prepayment speed assumption (annual rate)	–	15%
Impact on fair value of 10% adverse change	$ –	$ 1
Impact on fair value of 20% adverse change	$ –	$ 2
Residual cash flows discount rate (annual rate)	4.8%	4.8%
Impact on fair value of 10% adverse change	$ 393	$ –
Impact on fair value of 20% adverse change	$ 778	$ 1

	2012	
	Commercial mortgages	**Residential mortgages**
Fair value of deferred placement fees receivable	$ 37,075	$ 4,844
Average life (in months) [1]	45	14
Prepayment speed assumption (annual rate)	0.4%	15.0%
Impact on fair value of 10% adverse change	$ 10	$ 45
Impact on fair value of 20% adverse change	$ 19	$ 90
Residual cash flows discount rate (annual rate)	4.4%	4.1%
Impact on fair value of 10% adverse change	$ 359	$ 10
Impact on fair value of 20% adverse change	$ 710	$ 20

(1) The weighted-average life of prepayable assets in periods (for example, months or years) can be calculated by multiplying the principal collections expected in each future period by the number of periods until that future period, summing those products, and dividing the sum by the initial principal balance.

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

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

2014	$ 10,269
2015	6,970
2016	6,177
2017	5,204
2018 and thereafter	9,377
	$ 37,997

Note 5

Mortgages Accumulated for Sale or Securitization

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

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

	2013	2012
Mortgages accumulated for securitization	$ 1,063,068	$ 800,768
Mortgages accumulated for sale	11,757	7,754
	$ 1,074,825	$ 808,522

Note 6

Mortgage and Loan Investments

As at December 31, 2013, mortgage and loan investments consist primarily of commercial first and second mortgages held for various terms, the majority of which mature within one year.

Mortgage and loan investments consist of the following:

	2013	2012
		(Restated – Note 24)
Mortgage loans, classified as loans and receivables	$ 115,630	$ 148,013
Mortgage loans, designated as fair value through profit or loss	68,954	25,021
	$ 184,584	$ 173,034

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

The following table discloses the composition of the Company's portfolio of mortgage and loan investments by geographic region as at December 31, 2013:

Province/territory		Portfolio balance		Percentage of portfolio
Alberta	$	17,927	%	9.71
British Columbia		32,635		17.68
Manitoba		24,810		13.44
New Brunswick		4,246		2.30
Newfoundland and Labrador		2,873		1.56
Nova Scotia		4,549		2.46
Ontario		73,281		39.70
Quebec		22,258		12.06
Saskatchewan		1,102		0.60
Yukon		903		0.49
	$	184,584	%	100.0

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

Arrears (days)		2013		2012
31 to 60	$	278	$	12,699
61 to 90		409		181
Greater than 90		5,773		7,366
	$	15,903	$	20,246

The portfolio contains $3,900 (2012 – $543) of insured mortgages and $180,684 (2012 – $172,491) of uninsured mortgage and loan investments as at December 31, 2013.

Of the above total amount, the Company considers $4,914 (2012 – $6,938) as impaired, for which it has provided an allowance for potential loss of $4,041 (2012 – $5,679) as at December 31, 2013.

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

	2013						2012
	2014	2015	2016	2017	2018 and thereafter	Book value	Book value
Residential	$ 16,515	$ 747	$ 392	$ 356	$ 347	$ 18,357	$ 5,182
Commercial	116,458	30,276	8,325	10,265	903	166,227	167,852
	$ 132,973	$ 31,023	$ 8,717	$ 10,621	$ 1,250	$ 184,584	$ 173,034

Interest income for the year was $9,420 (2012 – $8,848) and is included in mortgage investment income on the consolidated statement of comprehensive income and retained earnings.

NOTE 7

Other Assets

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

		2013		2012
Property, plant and equipment, net	$	7,761	$	6,706
Intangible assets, net		12,500		18,064
Goodwill		29,776		29,776
	$	50,037	$	54,546

The intangible assets have a remaining amortization period of less than three years.

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

Note 8

Purchased Mortgage Servicing Rights

Purchased mortgage servicing rights consist of the following components:

	2013			2012		
	Cost	Accumulated amortization	Net book value	Cost	Accumulated amortization	Net book value
Third-party commercial mortgage servicing rights	$ 3,614	$ 3,183	$ 431	$ 3,614	$ 3,061	$ 553
Commercial mortgage-backed securities primary and master servicing rights	8,705	6,057	2,648	8,705	5,377	3,328
	$ 12,319	$ 9,240	$ 3,079	$ 12,319	$ 8,438	$ 3,881

The Company did not purchase any new servicing rights during the years ended December 31, 2013 and 2012. Amortization charged to income for the year ended December 31, 2013 was $802 (2012 – $890).

Note 9

Mortgages under Administration

As at December 31, 2013, the Company had mortgages under administration of $75,619,003 (2012 – $67,260,086), including mortgages held on the Company's consolidated statements of financial position. Mortgages under administration are serviced for financial institutions such as banks, insurance companies, pension funds, mutual funds, trust companies, credit unions and securitization vehicles. As at December 31, 2013, the Company administered 245,291 mortgages (2012 – 218,267) for 91 institutional investors (2012 – 90) with an average remaining term to maturity of 42 months (2012 – 42 months).

Mortgages under administration are serviced as follows:

	2013	2012
Institutional investors	$ 48,245,957	$ 44,618,488
Mortgages accumulated for sale or securitization and mortgage and loan investments	1,255,267	970,081
Securitization vehicles, deferred placement investors	5,075,254	4,844,379
Mortgages pledged under securitization	17,532,693	12,947,870
CMBS conduits	3,509,832	3,879,268
	$ 75,619,003	$ 67,260,086

The Company's exposure to credit loss is limited to mortgages under administration totalling $201,271 (2012 – $406,589), of which $4,971 of mortgages have principal and interest payments outstanding as at December 31, 2013 (2012 – $22,415). The Company incurred actual credit losses, net of recoveries, of $3,752 during the year ended December 31, 2013 (2012 – $3,234). As at December 31, 2013, the Company has $7,687 (2012 – $2,556) of uninsured non-performing mortgages (net of provisions for credit losses) included in accounts receivable and sundry.

The Company maintains trust accounts on behalf of the investors it represents. The Company also holds municipal tax funds in escrow for mortgagors. Since the Company does not hold a beneficial interest in these funds, they are not presented on the consolidated statement of financial position. The aggregate of these accounts as at December 31, 2013 was $405,426 (2012 – $419,368).

NOTE 10
Bank Indebtedness

Bank indebtedness includes a revolving credit facility of $570,000 (2012 – $545,000) maturing in December 2016, of which $258,421 (2012 – $197,717) was drawn as at December 31, 2013 and against which the following have been pledged as collateral:

(a) a general security agreement over all assets, other than real property, of the Company; and
(b) a general assignment of all mortgages owned by the Company.

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

Subsequent to the year end, the Company renegotiated the credit facility. The new agreement increased the commitment to $1 billion and extended the term to January 2018.

NOTE 11
Debt Related to Securitized and Participation Mortgages

Debt related to securitized mortgages represents the funding for mortgages pledged under the NHA MBS, CMB and ABCP programs. As at December 31, 2013, debt related to securitized mortgages was $17,872,627 (2012 – $13,241,712), net of unamortized discounts of $47,161 (2012 – $8,067). A comparison of the carrying amounts of the pledged mortgages and the related debt is summarized in note 3.

As at December 31, 2013, debt related to participation mortgages was $11,676 (2012 – $31,098).

Debt related to securitized and participation mortgages is reduced on a monthly basis when the principal payments received from the mortgages are applied. Debt discounts and premiums are amortized over the term of each debt on an effective yield basis.

NOTE 12
Swap Contracts

Swaps are over-the-counter contracts in which two counterparties exchange a series of cash flows based on agreed-upon rates to a notional amount. The Company used an interest rate swap to manage interest rate exposure relating to variability of interest earned on a portion of mortgages accumulated for sale held on the consolidated statements of financial position. The swap agreement that the Company entered into was an interest rate swap where two counterparties exchange a series of payments based on different interest rates applied to a notional amount in a single currency.

The following tables present, by remaining term to maturity, the notional amounts and fair values of the swap contract that do not qualify for hedge accounting as at December 31, 2013 and 2012:

	2013				
	Less than 3 years	**3 to 5 years**	**6 to 10 years**	**Total notional amount**	**Fair value**
Interest rate swap contract	$ 923,959	$ 1,678,567	$ 13,283	$ 2,615,808	$ 2,987

	2012				
	Less than 3 years	**3 to 5 years**	**6 to 10 years**	**Total notional amount**	**Fair value**
Interest rate swap contract	$ 224,262	$ 1,408,997	$ 457,816	$ 2,091,075	$ 3,224

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

Note 13

Debenture Loan Payable

The $175 million of five-year term senior secured debentures, with an interest rate of 5.07%, maturing on May 7, 2015, are secured on a pari-passu basis with the security under the one-year revolving line of credit described in bank indebtedness on advance. The net proceeds of the issuance were loaned to FNFLP at an interest rate of 5.1025% per annum. The Company used the proceeds of the debenture loan to repay a portion of its bank indebtedness under its existing bank credit facility. On the same date, the Company entered into a swap agreement to receive a 5.07% fixed coupon and pay monthly CDOR+2.134%, effectively protecting the Company against changes in fair value due to changes in interest rates. The swap agreement has been designated as a fair value hedge and matures on the due date of the debenture loan. The Company has a full guarantee on the debentures and the costs relating to the debenture issue have been borne by the Company.

Note 14

Commitments, Guarantees and Contingencies

As at December 31, 2013, the Company has the following operating lease commitments for its office premises:

2014	$	5,150
2015		5,160
2016		5,093
2017		5,073
2018 and thereafter		5,469
	$	25,945

Outstanding commitments for future advances on mortgages with terms of one to 10 years amounted to $803,991 as at December 31, 2013 (2012 – $641,060). The commitments generally remain open for a period of up to 90 days. These commitments have credit and interest rate risk profiles similar to those mortgages that are currently under administration. Certain of these commitments have been sold to institutional investors while others will expire before being drawn down. Accordingly, these amounts do not necessarily represent future cash requirements of the Company.

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

Note 15

Securities Transactions under Repurchase and Resale Transactions

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

Note 16

Obligations Related to Securities and Mortgages Sold under Repurchase Agreements

The Company uses repurchase agreements to fund specific mortgages included in mortgages accumulated for sale or securitization. The current contracts are with financial institutions, are based on bankers' acceptance rates and mature on or before January 31, 2014. Such agreements are entered into concurrently with a total return swap which, with the mortgage sale, is the economic equivalent of a repurchase agreement.

NOTE 17

Shareholders' Equity

(a) Authorized

Unlimited number of common shares

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

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

(b) Capital stock activities

	Common shares			Preferred shares		
Balance, December 31, 2012 and 2013	59,967,429	$	122,671	4,000,000	$	97,394

(c) Preferred shares

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

Holders of the Series 1 Preferred Shares are entitled to receive a cumulative quarterly fixed dividend yielding 4.65% annually for the initial period ending March 31, 2016. Thereafter, the dividend rate may be reset every five years at a rate equal to the five-year Government of Canada yield plus 2.07%, as and when approved by the Board of Directors.

Holders of Class A Series 1 Preferred Shares have the right, at their option, to convert their shares into cumulative, floating rate Class A Preferred Shares, Series 2 ("Series 2 Preferred Shares"), subject to certain conditions, on March 31, 2016 and on March 31 every five years thereafter. Holders of the Series 2 Preferred Shares will be entitled to receive cumulative quarterly floating dividends at a rate equal to the three-month Government of Canada treasury bill yield plus 2.07% as and when declared by the Board of Directors.

Preferred shares do not have voting rights. The par value per preferred share is $25.00.

(d) Earnings per share

		2013		2012
Net income attributable to shareholders	$	169,726	$	110,325
Less: dividends declared on preferred shares		(4,650)		(4,650)
Net earnings attributable to common shareholders	$	165,076	$	105,675
Number of common shares outstanding		59,967,429		59,967,429
Basic earnings per common share		$ 2.75		$ 1.76

Note 18

Income Taxes

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

	2013	2012
Income taxes relating to prior year	$ –	$ 187
Changes to tax legislation	–	689
Relates to origination and reversal of timing differences	18,300	1,724
	$ 18,300	$ 2,600

The major components of current income tax expense (recovery) for the years ended December 31 consist of the following:

	2013	2012
Income taxes relating to prior year	$ (260)	$ (262)
Income taxes relating to the year	43,370	38,500
Changes to tax legislation	–	(338)
	$ 43,110	$ 37,900

The effective income tax rate reported in the consolidated statements of comprehensive income and retained earnings varies from the Canadian tax rate of 26.37% for the year ended December 31, 2013 (2012 – 26.30%) for the following reasons:

	2013	2012
Company's statutory tax rate	26.37%	26.30%
Income before income taxes	$ 233,511	$ 150,825
Income tax at statutory tax rate	61,577	39,682
Increase (decrease) resulting from:		
Prior year adjustments	(260)	(75)
Income not subject to tax	(610)	–
Permanent differences	254	397
Differences in current and future tax rates	14	776
Change in tax legislation	–	(338)
Other	435	58
Income tax expense	$ 61,410	$ 40,500

Significant components of the Company's deferred tax liabilities for the year ended December 31 are as follows:

	2013	2012
Deferred placement fees receivable	$ 8,855	$ 11,025
Capitalized broker fees	21,358	14,499
Carrying values of mortgages pledged under securitization in excess of tax values	10,009	8,168
Intangible assets	3,296	4,751
Unamortized discount on debt related to securitized mortgages	12,436	2,122
Cumulative eligible capital property	(6,063)	(6,502)
Gains (losses) on interest rate swaps	978	(1,051)
Loan loss reserves not deducted for tax purposes	(845)	(1,583)
Debenture issuance costs	(67)	(117)
Share issuance costs	(422)	(644)
Other	1,665	2,232
Deferred tax liabilities	$ 51,200	$ 32,900

The movements in significant components of the Company's deferred tax liabilities and assets for the year ended December 31, 2013 and 2012 are as follows:

	As at January 1 2013	Recognized in income	As at December 31 2013
Deferred income tax liabilities			
Deferred placement fees receivable	$ 11,025	$ (2,170)	$ 8,855
Capitalized broker fees	14,499	6,859	21,358
Carrying values of mortgages pledged under securitization in excess of tax values	8,168	1,841	10,009
Gains on interest rate swaps	–	978	978
Intangible assets	4,751	(1,455)	3,296
Unamortized discount on debt related to securitized mortgages	2,122	10,314	12,436
Other	2,232	(567)	1,665
Total deferred income tax liabilities	$ 42,797	$ 15,800	$ 58,597
Deferred income tax assets			
Cumulative eligible capital property	(6,502)	439	(6,063)
Loan loss reserves not deducted for tax purposes	(1,583)	738	(845)
Losses on interest rate swaps	(1,051)	1,051	–
Debenture issuance costs	(117)	50	(67)
Share issuance costs	(644)	222	(422)
Total deferred income tax assets	$ (9,897)	$ 2,500	$ (7,397)
Net deferred income tax liabilities	$ 32,900	$ 18,300	$ 51,200

		As at January 1 2012		Recognized in income		As at December 31 2012
Deferred income tax liabilities						
Deferred placement fees receivable	$	15,008	$	(3,983)	$	11,025
Capitalized broker fees		12,704		1,795		14,499
Carrying values of mortgages pledged under securitization in excess of tax values		8,391		(223)		8,168
Intangible assets		6,257		(1,506)		4,751
Unamortized discount on debt related to securitized mortgages		1,156		966		2,122
Other		2,028		204		2,232
Total deferred income tax liabilities	$	45,544	$	(2,747)	$	42,797
Deferred income tax assets						
Cumulative eligible capital property		(6,711)		209		(6,502)
Losses on interest rate swaps		(4,988)		3,937		(1,051)
Loan loss reserves not deducted for tax purposes		(2,543)		960		(1,583)
Debenture issuance costs		(162)		45		(117)
Share issuance costs		(840)		196		(644)
Total deferred income tax assets	$	(15,244)	$	5,347	$	(9,897)
Net deferred income tax liabilities	$	30,300	$	2,600	$	32,900

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

Note 19

Financial Instruments and Risk Management

Risk management

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

Interest rate risk

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

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

For single-family mortgages, only a portion of the commitments issued by the Company eventually fund. The Company must assign a probability of funding to each mortgage in the pipeline and estimate how that probability changes as mortgages move through the various stages of the pipeline. The amount that is actually economically hedged is the expected value of the mortgages funding within the future commitment period. The Company also hedges against interest rate fluctuations by offsetting the exposure of the Company's bank indebtedness and funds held in trust. Bank indebtedness, obligations related to debt and the debenture loan payable (after the effect of the interest rate swap) are all floating rate obligations indexed to 30-day CDOR; the funds held in trust earn the Company interest based on the same floating rate basis. Because both the indebtedness and funds held in trust have comparable values, with the liabilities at $883,776 (2012 – $685,652) as at December 31, 2013 and the funds held in trust at $617,227 (2012 – $561,204) on the same date, the Company considers the arrangement to be a natural hedge against short-term interest rate fluctuations.

The table below provides the financial impact that an immediate and sustained 100 basis point and 200 basis point increase and decrease in short-term interest rates would have had on the net income of the Company in 2013 and 2012.

	Increase in interest rate		Decrease in interest rate[1]	
	2013	**2012**	**2013**	**2012**
100 basis point shift				
Impact on net income and shareholders' equity	$ 1,414	$ 234	$ (1,414)	$ (234)
200 basis point shift				
Impact on net income and shareholders' equity	$ 7,157	$ 468	$ (2,828)	$ 3,676

(1) Interest rate is not to be decreased to below 0%.

The Company has exposure to the risk that short-term interest rates increase, and credit losses as the Company has a first-loss position. Accordingly, these mortgages are much more sensitive to changes in interest rates and credit loss than the Company's typical mortgage and loan investments.

The Company's accounts receivable and sundry, accounts payable and accrued liabilities, and purchased mortgage servicing rights are not exposed to interest rate risk.

Credit risk

Credit risk is the risk of loss associated with a counterparty's inability or unwillingness to fulfill its payment obligations. The Company's credit risk is mainly lending related in the form of mortgage default. The Company uses stringent underwriting criteria and experienced adjudicators to mitigate this risk. The Company's approach to managing credit risk is based on the consistent application of a detailed set of credit policies and prudent arrears management. As at December 31, 2013, 99% (2012 – 92%) of the pledged mortgages were insured mortgages. See details in note 3. The Company's exposure is further mitigated by the relatively short period over which a mortgage is held by the Company prior to securitization.

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

The Company is at risk that the underlying mortgages will default and the servicing cash flows will cease. The large portfolio of individual mortgages that underlies these assets is diverse in terms of geographical location, borrower exposure and the underlying type of real estate. This diversity and the priority ranking of the Company's rights mitigate the potential size of any single credit loss. Securities purchased under resale agreements are transacted with large regulated Canadian institutions such that the risk of credit loss is very remote. Securities transacted are all Government of Canada bonds and, as such, have virtually no risk of credit loss.

Liquidity risk and capital resources

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

The Company's liquidity strategy has been to use bank credit to fund working capital requirements and to use cash flow from operations to fund longer-term assets. The Company's credit facilities are typically drawn to fund: (i) mortgages accumulated for sale or securitization, (ii) origination costs associated with mortgages pledged under securitization, (iii) cash held as collateral for securitization, (iv) costs associated with deferred placement fees receivable and (v) mortgage and loan investments. The Company has a credit facility with a syndicate of seven financial institutions, which provides for a total of $570,000 in financing. Bank indebtedness also includes borrowings obtained through outstanding cheques and overdraft facilities.

Subsequent to the year end, the Company renegotiated the credit facility. The new agreement increased the commitment to $1 billion and extended the term to January 2018.

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

Market risk

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

Customer concentration risk

Placement fees and mortgage servicing income from one (2012 – two) Canadian financial institution represent approximately 16% (2012 – 36%) of the Company's total revenue. During the year ended December 31, 2013, the Company placed 31% (2012 – 62%) of all mortgages it originated with the same (2012 – two) institutional investor.

Fair value measurement

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

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

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

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

Valuation methods and assumptions

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

(a) HFT mortgages in mortgages under securitization and certain mortgage and loan investments

The fair value of these mortgages is determined by discounting projected cash flows using market industry pricing practices. Discount rates used are determined by comparison to similar term loans made to borrowers with similar credit. This methodology will reflect changes in interest rates which have occurred since the mortgages were originated. Impaired mortgages are recorded at net realizable value.

(b) *Deferred placement fees receivable*

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

(c) *Securities owned and sold short*

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

(d) *Other financial assets and financial liabilities*

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

Carrying value and fair value of selected financial instruments

The following tables provide a comparison of the carrying and fair values for each classification of financial instruments as at December 31:

	2013				
	Financial instruments classified as FVTPL	Financial instruments designated as FVTPL	Loans and receivables/ financial liabilities at amortized cost	Total carrying value	Total fair value
Financial assets					
Restricted cash	$ –	$ –	$ 431,111	$ 431,111	$ 432,518
Accounts receivable and sundry	–	6,976	53,134	60,110	58,703
Securities purchased under resale agreements and owned	–	–	1,055,443	1,055,443	1,055,443
Mortgages accumulated for sale or securitization	11,757	–	1,063,068	1,074,825	1,074,825
Mortgages pledged under securitization	–	3,969,524	13,682,120	17,651,644	17,729,958
Deferred placement fees receivable	–	33,580	–	33,580	33,580
Cash held as collateral for securitization	–	–	24,804	24,804	24,804
Mortgage and loan investments	–	68,954	115,630	184,584	184,584
Total financial assets	$ 11,757	$ 4,079,034	$ 16,425,310	$ 20,516,101	$ 20,594,415
Financial liabilities					
Bank indebtedness	$ –	$ –	$ 274,484	$ 274,484	$ 274,484
Obligations related to securities and mortgages sold under repurchase agreements	–	–	609,292	609,292	609,292
Accounts payable and accrued liabilities	–	3,639	62,787	66,426	66,426
Securities sold under repurchase agreements and sold short	–	1,050,199	–	1,050,199	1,050,199
Debt related to securitized and participation mortgages	–	–	17,884,303	17,884,303	17,911,851
Debenture loan payable	–	179,195	–	179,195	179,195
Total financial liabilities	$ –	$ 1,233,033	$ 18,830,866	$ 20,063,899	$ 20,091,447

	2012				
	Financial instruments classified as FVTPL	Financial instruments designated as FVTPL	Loans and receivables/ financial liabilities at amortized cost	Total carrying value	Total fair value
Financial assets					
Restricted cash	$ –	$ –	$ 334,962	$ 334,962	$ 334,962
Accounts receivable and sundry	–	8,615	42,687	51,302	51,302
Securities purchased under resale agreements and owned	–	–	452,534	452,534	452,534
Mortgages accumulated for sale or securitization	7,754	–	800,768	808,522	808,522
Mortgages pledged under securitization	–	3,118,827	9,913,216	13,032,043	13,272,361
Deferred placement fees receivable	–	41,919	–	41,919	41,919
Cash held as collateral for securitization	–	–	69,493	69,493	69,493
Mortgage and loan investments	–	25,021	148,013	173,034	173,034
Total financial assets	$ 7,754	$ 3,194,382	$ 11,761,673	$ 14,963,809	$ 15,204,127
Financial liabilities					
Bank indebtedness	$ –	$ –	$ 155,197	$ 155,197	$ 155,197
Obligations related to securities and mortgages sold under repurchase agreements	–	–	500,608	500,608	500,608
Accounts payable and accrued liabilities	–	6,660	53,721	60,381	60,381
Securities sold under repurchase agreements and sold short	–	451,875	–	451,875	451,875
Debt related to securitized and participation mortgages	–	–	13,272,810	13,272,810	13,379,811
Debenture loan payable	–	181,275	–	181,275	181,275
Total financial liabilities	$ –	$ 639,810	$ 13,982,336	$ 14,622,146	$ 14,729,147

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

	2013			
	Level 1	Level 2	Level 3	Total
Financial assets				
Mortgages accumulated for sale	$ –	$ 11,757	$ –	$ 11,757
HFT mortgages	–	–	3,969,524	3,969,524
Deferred placement fees receivable	–	–	33,580	33,580
Mortgage and loan investments	–	–	68,954	68,954
Interest rate swaps	–	6,976	–	6,976
Total financial assets	$ –	$ 18,733	$ 4,072,058	$ 4,090,791
Financial liabilities				
Securities sold under repurchase agreements and sold short	$ 1,050,199	$ –	$ –	$ 1,050,199
Interest rate swaps	–	3,639	–	3,639
Total financial liabilities	$ 1,050,199	$ 3,639	$ –	$ 1,053,838

	2012			
	Level 1	Level 2	Level 3	Total
Financial assets				
Mortgages accumulated for sale	$ –	$ 7,754	$ –	$ 7,754
HFT mortgages	–	–	3,118,827	3,118,827
Deferred placement fees receivable	–	–	41,919	41,919
Mortgage and loan investments	–	–	25,021	25,021
Interest rate swaps	–	8,615	–	8,615
Total financial assets	$ –	$ 16,369	$ 3,185,767	$ 3,202,136
Financial liabilities				
Securities sold under repurchase agreements and sold short	$ 451,875	$ –	$ –	$ 451,875
Interest rate swaps	–	6,818	–	6,818
Total financial liabilities	$ 451,875	$ 6,818	$ –	$ 458,693

In estimating the fair value of financial assets and financial liabilities using valuation techniques or pricing models, certain assumptions are used, including those that are not fully supported by observable market prices or rates (level 3). The amount of the change in fair value recognized by the Company in net income for the year ended December 31, 2013 that was estimated using a valuation technique based on assumptions that are not fully supported by observable market prices or rates was a gain of approximately $19,286 (2012 – $16,755). Although the Company's management believes that the estimated fair values are appropriate as at the date of the consolidated statements of financial position, those fair values may differ if other reasonably possible alternative assumptions are used.

The following table presents changes in the fair values, including realized gains of $24,580 (2012 – realized losses of $10,602) of the Company's financial assets and financial liabilities for the years ended December 31, 2013 and 2012, all of which have been classified as fair value through profit or loss:

	2013	2012
HFT mortgages	$ 15,141	$ 4,623
Deferred placement fees receivable	(297)	(203)
Mortgage and loan investments	–	(374)
Securities owned and sold short	28,668	1,934
Interest rate swaps	354	173
	$ 43,866	$ 6,153

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

Movement in Level 3 financial instruments measured at fair value

The following tables show the movement in Level 3 financial instruments in the fair value hierarchy for the years ended December 31, 2013 and 2012 (restated). The Company classifies financial instruments to Level 3 when there is reliance on at least one significant unobservable input in the valuation models.

	Fair value as at January 1 2013	Investments	Unrealized gain (loss) recorded in income	Payment and amortization	Fair value as at December 31 2013
Financial assets					
HFT mortgages	$ 3,118,827	$ 3,546,819	$ 18,907	$ (2,715,029)	$ 3,969,524
Deferred placement fees receivable	41,919	9,912	(296)	(17,955)	33,580
Mortgage and loan investments	25,021	46,117	–	(2,184)	68,954
Total financial assets	$ 3,185,767	$ 3,602,848	$ 18,611	$ (2,735,168)	$ 4,072,058

	Fair value as at January 1 2012	Investments	Unrealized gain (loss) recorded in income	Payment and amortization	Fair value as at December 31 2012
Financial assets					
HFT mortgages	$ 2,672,163	$ 3,257,342	$ 9,786	$ (2,820,464)	$ 3,118,827
Deferred placement fees receivable	58,509	5,976	(203)	(22,363)	41,919
Mortgage and loan investments	5,801	13,636	(450)	6,034	25,021
Total financial assets	$ 2,736,473	$ 3,276,954	$ 9,133	$ (2,836,793)	$ 3,185,767

Derivative financial instrument and hedge accounting

The Company entered into a swap agreement to hedge the debenture loan payable against changes in fair value by converting the fixed-rate debt into a variable-rate debt. The swap agreement has been designated as a fair value hedge and the hedging relationship is formally documented, including the risk management objective and measurement of effectiveness. The swap agreement is recorded at fair value with the changes in fair value recognized in income. Changes in fair value attributed to the hedged risk are accounted for as basis adjustments to the debenture loan payable and are recognized in income. Accordingly, as at December 31, 2013, accounts receivable and sundry have been increased by $4,195 (2012 – $6,275) to account for the swap derivative, and the debenture loan payable has been increased by the same amount.

NOTE 20

Capital Management

The Company's objective is to maintain a strong capital base so as to maintain investor, creditor and market confidence and sustain future development of the business. Management defines capital as the Company's equity, debenture loan payable and retained earnings. The Company has a minimum capital requirement as stipulated by its bank credit facility. The agreement limits the debt under bank indebtedness together with the debentures to four times FNFLP's equity. As at December 31, 2013, the ratio was 1.1:1 (2012 – 1.2:1). The Company was in compliance with the bank covenant throughout the year.

NOTE 21

Earnings by Business Segment

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

	2013		
	Residential	**Commercial**	**Total**
REVENUE			
Interest revenue – securitized mortgages	$ 315,512	$ 113,711	$ 429,223
Interest expense – securitized mortgages	(232,626)	(90,610)	(323,236)
Net interest – securitized mortgages	82,886	23,101	105,987
Placement and servicing	241,427	51,692	293,119
Mortgage investment income	34,037	20,129	54,166
	358,350	94,922	453,272
EXPENSES			
Amortization	5,176	2,761	7,937
Interest	26,663	2,507	29,170
Other operating	151,462	31,192	182,654
	183,301	36,460	219,761
Income before income taxes	$ 175,049	$ 58,462	$ 233,511
Identifiable assets	16,282,131	4,257,310	20,539,441
Goodwill	–	–	29,776
Total assets	$ 16,282,131	$ 4,257,310	$ 20,569,217
Capital expenditures	$ 2,400	$ 1,028	$ 3,428

	2012		
	Residential	**Commercial**	**Total**
REVENUE			
Interest revenue – securitized mortgages	$ 226,607	$ 110,380	$ 336,987
Interest expense – securitized mortgages	(160,068)	(86,668)	(246,736)
Net interest – securitized mortgages	66,539	23,712	90,251
Placement and servicing	218,728	36,964	255,692
Mortgage investment income	20,258	15,676	35,934
	305,525	76,352	381,877
EXPENSES			
Amortization	5,507	3,019	8,526
Interest	17,682	2,147	19,829
Other operating	174,686	28,011	202,697
	197,875	33,177	231,052
Income before income taxes	$ 107,650	$ 43,175	$ 150,825
Identifiable assets	11,426,562	3,565,898	14,992,460
Goodwill	–	–	29,776
Total assets	$ 11,426,562	$ 3,565,898	$ 15,022,236
Capital expenditures	$ 2,069	$ 886	$ 2,955

Note 22

Related Party Transactions

For the past three years, several of the Company's commercial borrowers applied to the Company for mezzanine mortgage financing. The amounts of the mortgages requested were in excess of the Company's internal investment policies for investments of that nature; however, businesses controlled by a senior executive and shareholder of the Company entered into agreements with the borrowers to fund the mortgages. The Company serviced these mortgages during their terms at market commercial servicing rates. The mortgages which are administered by the Company have a balance of $31,245 as at December 31, 2013 (2012 – $29,685). During the year, the Company originated and placed $7.0 million of new mortgages to these related-party companies.

A senior executive and shareholder of the Company has a significant investment in a mortgage default insurance company. In the ordinary course of business, the insurance company provides insurance policies to the Company's borrowers at market rates. Beginning in the third quarter of 2012, the insurance company also provided the Company with portfolio insurance at market premiums. The total bulk insurance purchased during 2013 was $2,348 (2012 – $913), net of third-party investor reimbursement. The insurance company has also engaged the Company to service a portfolio of mortgages at market commercial servicing rates. As at December 31, 2013, the portfolio had an outstanding balance of $9.0 million (December 31, 2012 – $11.0 million).

A senior executive and shareholder of the Company is a director on the board of a retirement home company. The Company has provided a commitment to fund up to $10 million through a secured revolving line of credit until January 2015 to the retirement home company. The Company earns a standby fee at market rate on any undrawn portion to the end of the commitment period. The total standby fees earned by the Company in the year were $28.

During the year ended December 31, 2013, the Company paid a total compensation of $3,657 (2012 – $3,008) to six (2012 – five) senior managers.

NOTE 23

Future Accounting Changes

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

IFRS 9 – Financial Instruments

In November 2009, the IASB issued IFRS 9 as part of its plan to replace IAS 39 – *Financial Instruments: Recognition and Measurement*. IFRS 9 provides new requirements for how an entity should classify and measure financial assets and financial liabilities that are in the scope of IAS 39. IFRS 9 has also introduced the proposed expected credit loss model for credit loss provision and a general hedge accounting model which expands the scope of permissible hedging relationships. In February 2014, the IASB has decided to defer the mandatory effective date from January 1, 2015 to the currently expected date of January 1, 2018. Management is currently evaluating the potential impact that the adoption of IFRS 9 will have on the Company's consolidated financial statements.

IAS 32 – Financial Instruments: Presentation

As at January 1, 2014, the Company will be required to adopt this standard which clarifies the existing requirements for offsetting financial assets and financial liabilities. The amendment is not expected to have a material impact on the Company's consolidated financial statements.

IFRIC 21 – IFRS Interpretations Committee Interpretation 21: Levies

In May 2013, the IASB issued IFRIC 21, which requires an entity to recognize a liability for a levy when the activity that triggers payment occurs. The Company will adopt this standard on January 1, 2014.

NOTE 24

Comparative Consolidated Financial Statements

The comparative audited consolidated financial statements have been restated from statements previously presented to conform to the presentation of the 2013 audited consolidated financial statements for the adoption of IFRS 10.

Corporate Governance

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

Sound corporate governance is fundamental to maintaining the confidence of investors and increasing shareholder value. As such, First National is committed to the highest standards of integrity, transparency, compliance and discipline.

These standards define the relationships among all of our stakeholders – Board, management and shareholders – and are the basis for building these values and nurturing a culture of accountability and responsibility across the organization.

Policies

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

Committees

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

Audit Committee

The Audit Committee's responsibilities include:

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

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

COMMITTEE MEMBERS

John Brough (Chair), Peter Copestake and Robert Mitchell

Compensation, Governance and Nominating Committee

The Compensation, Governance and Nominating Committee's responsibilities include:

- Making recommendations concerning the compensation of the Company's senior executive officers;
- Developing the Company's approach to corporate governance issues and compliance with applicable laws, regulations, rules, policies and orders with respect to such issues;
- Advising the Board of Directors on filling director vacancies;
- Periodically reviewing the composition and effectiveness of the directors and the contributions of individual directors; and
- Adopting and periodically reviewing and updating the Company's written Disclosure Policy.

The Compensation, Governance and Nominating Committee consists of three independent directors for the purposes of the Canadian Securities Administrators' Multilateral Instrument 58-101 – *Disclosure of Corporate Governance Practices*.

COMMITTEE MEMBERS

Peter Copestake (Chair), Duncan Jackman and Barbara Palk

Board Members

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

Stephen Smith is Chairman, President and Chief Executive Officer of the Corporation, President of First National and co-founder of First National. Mr. Smith, one of Canada's leading financial services entrepreneurs, has been an innovator in the development and utilization of various securitization techniques to finance mortgage assets and has been a regular speaker at financial services conferences. He is Chairman of the Canada Guaranty Mortgage Insurance Company as well as a director of The Empire Life Insurance Company. He is also Vice Chair of Metrolinx Inc. (GO Transit) and a member of the Board of the C.D. Howe Institute. In addition, Mr. Smith is on the Advisory Council of the Royal Conservatory of Music and the Chair of The Historica-Dominion Institute. Mr. Smith has a Master of Science (Economics) from the London School of Economics and Political Science, a Bachelor of Science (Honours) in Electrical Engineering, Queen's University, and is a member of the Association of Professional Engineers of Ontario and the Canadian Council of Chief Executives. Mr. Smith is a graduate of the Directors Education Program at the University of Toronto, Rotman School of Management. In 2012, he was awarded The Queen's Diamond Jubilee Medal for contributions to Canada.

Moray Tawse is Executive Vice President and Secretary of the Corporation, Executive Vice President, Mortgage Investments of First National and co-founder of First National. Mr. Tawse directs the operations of all of First National's commercial mortgage origination activities. With over 30 years of experience in the real estate finance industry, Mr. Tawse is one of Canada's leading experts on commercial real estate and is often called upon to deliver keynote addresses at national real estate symposiums. In addition, Mr. Tawse is also an independent director of Regal Lifestyle Communities Inc., a TSX listed company that owns and operates retirement properties across Canada and of BLF REIT, a TSX Venture listed company that owns and manages multi-unit residential properties, mainly in Quebec.

John Brough served as President of both Wittington Properties Limited (Canada) and Torwest, Inc. (United States) real estate development companies from 1998 to 2007. From 1974 until 1996 he was with Markborough Properties, Inc, where he was Senior Vice President and Chief Financial Officer from 1986 until 1996. Mr. Brough is a Director of Kinross Gold Corporation, Silver Wheaton Corp. and Canadian Real Estate Investment Trust. Mr. Brough has a Bachelor of Arts (Economics) degree from the University of Toronto, as well as a Chartered Accountant degree. Mr. Brough is a graduate of the Directors Education Program at the University of Toronto, Rotman School of Management, is a member of the Institute of Corporate Directors and holds the designation Chartered Professional Accountant.

Peter Copestake currently serves as the founding CEO of Continental Bank of Canada, a new Canadian Schedule 1 Chartered Bank. He also continues to serve as the Executive in Residence at the Queen's University School of Business and as a corporate director and business consultant. Over the past 30 years he has held senior financial and executive management positions at federally regulated financial institutions and in the federal government. Other current directorships include membership on the Finance and Pension committees of Queen's University and directorships at Royal and Sun Alliance Insurance Company of Canada and Canadian Derivatives Clearing Corporation. He additionally serves on the Independent Review Committees at First Trust Portfolios Canada and at PIMCO Canada and as Chair of the Southeastern Ontario Academic Medical Organization.

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

Robert Mitchell has been President of Dixon Mitchell Investment Counsel Inc., a Vancouver-based investment management company since 2000. Prior to that, Mr. Mitchell was Vice President, Investments at Seaboard Life Insurance Company. Mr. Mitchell is a director and chairs the audit committee for Discovery Parks Holdings Ltd., and is a trustee for Discovery Parks Trust. Discovery Parks Trust was established to support the high technology and research industries in British Columbia through the development of its real estate assets. Mr. Mitchell has an MBA from University of Western Ontario, a Bachelor of Commerce (Finance) from University of Calgary, and is a CFA charterholder.

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

Shareholder Information

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Annual Meeting
May 5, 2014, 10 a.m. EDT
TMX Broadcast Centre
The Gallery
The Exchange Tower
130 King Street West
Toronto, Ontario

Senior Executives of First National Financial LP

Stephen Smith
Co-founder, Chairman, President and
Chief Executive Officer

Moray Tawse
Co-founder and Executive Vice President

Robert Inglis
Chief Financial Officer

Scott McKenzie
Senior Vice President, Residential Mortgages

Jeremy Wedgbury
Senior Vice President, Commercial Mortgages

Lisa White
Vice President, Mortgage Administration

Hilda Wong
General Counsel

Jason Ellis
Managing Director, Capital Markets

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Exchange Listing and Symbols
Common shares: (TSX) FN
Preferred shares: (TSX) FN.PR.A

FIRST NATIONAL
FINANCIAL CORPORATION

DELIVERING SERVICE
CREATING SOLUTIONS
BUILDING SUCCESS

VANCOUVER | CALGARY |
TORONTO | MONTREAL | HALIFAX