

Management's Responsibility for Financial Information

The consolidated financial statements of Home Capital Group Inc. were prepared by management, which is responsible for the integrity and fairness of the financial information presented. The consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles, including the accounting requirements specified by the Office of the Superintendent of Financial Institutions Canada that apply to its subsidiary Home Trust Company. The financial statements reflect amounts which must, of necessity, be based on the best estimates and judgement of management with appropriate consideration as to materiality. The financial information presented elsewhere in this Annual Report is consistent with that in the financial statements.

Management is responsible for ensuring the fairness and integrity of the financial information. It is also responsible for the implementation of the supporting accounting systems. In discharging its responsibilities, management maintains the necessary internal control system designed to provide assurance that the transactions are properly authorized, assets are safeguarded and proper accounting records are held. The controls include quality standards in hiring and training of employees, written policies, authorized limits for managers, procedure manuals, a corporate code of conduct and appropriate management information systems.

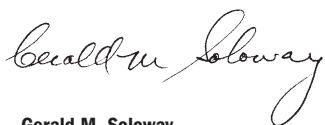
The internal control systems are further supported by a compliance function, which ensures that the Company and its employees comply with all regulatory requirements, as well as by a risk integration function and an operating risk management function that ensure proper risk control, related documentation and the measurement of the financial impact of risks. In addition, the internal auditor periodically evaluates various aspects of the Company's operations and makes recommendations to management for, among other things, improvements to the control systems.

Every year, the Office of the Superintendent of Financial Institutions Canada makes such examinations and inquiries as deemed necessary to satisfy itself that Home Trust Company is in a sound financial position and that it complies with the provisions of the Trust and Loan Companies Act (Canada).

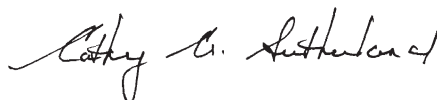
Ernst & Young LLP, independent auditors, appointed by the shareholders, perform an audit of the Company's consolidated financial statements and their report follows.

The internal auditor, the external auditors and the Office of the Superintendent of Financial Institutions Canada meet periodically with the Audit Committee, with management either present or absent, to discuss all aspects of their duties and matters arising therefrom.

The Board of Directors is responsible for reviewing and approving the financial statements and Management's Discussion and Analysis of results of operations and financial condition appearing in the Annual Report. It oversees the manner in which management discharges its responsibilities for the presentation and preparation of financial statements, maintenance of appropriate internal controls, risk management as well as assessment of significant transactions and related party transactions through its Audit Committee. The Audit Committee is composed solely of Directors who are not Officers or employees of the Company.



Gerald M. Soloway
Chief Executive Officer
Toronto, Canada
March 9, 2011



Cathy A. Sutherland, C.A.
Senior Vice President, Finance

Independent Auditors' Report

To the Shareholders of **Home Capital Group Inc.**

We have audited the accompanying consolidated financial statements of **Home Capital Group Inc.**, which comprise the consolidated balance sheets as at December 31, 2010 and 2009, and the consolidated statements of income, comprehensive income, changes in shareholders' 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 Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

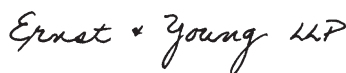
An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the consolidated financial statements, 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 Home Capital Group Inc. as at December 31, 2010 and 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Toronto, Canada
March 9, 2011



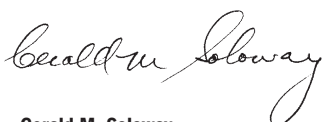
Chartered Accountants
Licensed Public Accountants

Consolidated Balance Sheets

| As at December 31 (000s) | 2010 | 2009 |
|---|----------------------------|--------------|
| ASSETS | | |
| Cash resources | (Note 3) \$ 846,824 | \$ 930,134 |
| Securities | (Note 3) | |
| Held for trading | - | 99,938 |
| Available for sale | 543,892 | 550,659 |
| | 543,892 | 650,597 |
| Loans | (Note 4) | |
| Residential mortgages | 4,570,130 | 4,417,197 |
| Non-residential mortgages | 838,253 | 708,425 |
| Personal and credit card loans | 453,339 | 342,918 |
| | 5,861,722 | 5,468,540 |
| General allowance for credit losses | (29,153) | (27,793) |
| | 5,832,569 | 5,440,747 |
| Other | | |
| Securitization receivables | (Note 5) 343,402 | 229,418 |
| Capital assets | (Note 6) 4,894 | 4,863 |
| Other assets | (Note 7) 140,658 | 105,115 |
| | 488,954 | 339,396 |
| | \$ 7,712,239 | \$ 7,360,874 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Deposits | (Note 8) | |
| Payable on demand | \$ 50,359 | \$ 38,223 |
| Payable on a fixed date | 6,472,491 | 6,371,599 |
| | 6,522,850 | 6,409,822 |
| Other | | |
| Cheques and other items in transit | 5,241 | 4,617 |
| Other liabilities | (Note 9) 441,868 | 356,147 |
| | 447,109 | 360,764 |
| | 6,969,959 | 6,770,586 |
| Commitments and contingencies | (Note 14) - | - |
| SHAREHOLDERS' EQUITY | | |
| Capital stock | (Note 10) 50,427 | 45,396 |
| Contributed surplus | 3,649 | 3,606 |
| Retained earnings | 669,475 | 520,018 |
| Accumulated other comprehensive income | 18,729 | 21,268 |
| | 742,280 | 590,288 |
| | \$ 7,712,239 | \$ 7,360,874 |

See accompanying notes

On behalf of the Board:



Gerald M. Soloway
Chief Executive Officer



Robert A. Mitchell
Chair of Audit Committee

Consolidated Statements of Income

| Year ended December 31 (000s, except per share amounts) | 2010 | 2009 |
|--|-------------------|------------|
| Income | | |
| Interest from loans | \$ 354,222 | \$ 334,148 |
| Dividends from securities | 18,204 | 17,742 |
| Other interest | 9,806 | 13,214 |
| | 382,232 | 365,104 |
| Interest expense | | |
| Interest on deposits | 188,370 | 200,093 |
| Net interest income | | |
| Provision for credit losses (Note 4(e)) | 9,411 | 11,526 |
| | 184,451 | 153,485 |
| Non-interest income | | |
| Fees and other income | 30,690 | 29,326 |
| Securitization income (Note 5) | 107,724 | 92,397 |
| Gain on sale of loan portfolio (Note 4(g)) | 3,917 | - |
| Net realized and unrealized gain on securities | 8,953 | 2,097 |
| Net realized and unrealized gain on derivatives | 421 | 255 |
| | 151,705 | 124,075 |
| | 336,156 | 277,560 |
| Non-interest expenses | | |
| Salaries and benefits | 46,739 | 41,559 |
| Premises | 6,894 | 5,916 |
| General and administration | 40,306 | 31,126 |
| | 93,939 | 78,601 |
| Income before income taxes | | |
| | 242,217 | 198,959 |
| Income taxes (Note 12) | | |
| Current | 35,231 | 27,825 |
| Future | 26,042 | 26,641 |
| | 61,273 | 54,466 |
| Net income for the year | | |
| | \$ 180,944 | \$ 144,493 |
| Average number of common shares outstanding (Note 10) | | |
| Basic | 34,697 | 34,450 |
| Diluted | 34,776 | 34,795 |
| Net income per common share (Note 10) | | |
| Basic | \$ 5.21 | \$ 4.19 |
| Diluted | \$ 5.20 | \$ 4.15 |

See accompanying notes

Consolidated Statements of Comprehensive Income

| Year ended December 31 (000s) | 2010 | 2009 |
|---|-------------------|-------------------|
| Net income | \$ 180,944 | \$ 144,493 |
| Other comprehensive (loss) income, net of tax | | |
| Net unrealized gains on securities available for sale (net of \$(221) tax; \$8,739 in 2009) | 3,003 | 22,092 |
| Reclassification of (gains) losses in respect of available for sale securities (net of \$2,728 tax; \$(4,941) in 2009) | (5,542) | 10,229 |
| Total other comprehensive (loss) income | (2,539) | 32,321 |
| Comprehensive income | \$ 178,405 | \$ 176,814 |

See accompanying notes

Consolidated Statements of Changes in Shareholders' Equity

| Year ended December 31 (000s) | 2010 | 2009 |
|--|-------------------|-------------------|
| Capital stock | (Note 10) | |
| Common shares | | |
| Balance, beginning of year | \$ 45,396 | \$ 39,094 |
| Proceeds of options exercised | 5,309 | 6,498 |
| Repurchase of shares | (278) | (196) |
| Balance, end of year | \$ 50,427 | \$ 45,396 |
| Contributed surplus | | |
| Balance, beginning of year | \$ 3,606 | \$ 3,283 |
| Amortization of fair value of employee stock options | 1,203 | 1,543 |
| Exercise of stock appreciation rights | (280) | - |
| Employee stock options settled | (880) | (1,220) |
| Balance, end of year | \$ 3,649 | \$ 3,606 |
| Retained earnings | | |
| Balance, beginning of year | \$ 520,018 | \$ 401,429 |
| Net income for the year | 180,944 | 144,493 |
| Dividends paid or declared during the year | (23,241) | (21,435) |
| Repurchase of shares | (8,246) | (4,469) |
| | (Note 10(c)) | |
| Balance, end of year | \$ 669,475 | \$ 520,018 |
| Accumulated other comprehensive income (loss) | (Note 11) | |
| Balance, beginning of year | \$ 21,268 | \$ (11,053) |
| Other comprehensive (loss) income (net of \$2,507 tax; \$3,798 in 2009) | (2,539) | 32,321 |
| Balance, end of year | \$ 18,729 | \$ 21,268 |

See accompanying notes

Consolidated Statements of Cash Flows

| Year ended December 31 (000s) | 2010 | 2009 |
|--|-------------------------------|--------------------|
| OPERATING ACTIVITIES | | |
| Net income for the year | \$ 180,944 | \$ 144,493 |
| Adjustments to determine net cash flows relating to operating activities | | |
| Future income taxes | 26,042 | 26,641 |
| Amortization of capital assets | 2,881 | 2,644 |
| Amortization of intangibles and other deferred assets | 77 | 908 |
| Amortization of securities | 2,073 | (1,979) |
| Provision for credit losses | 9,411 | 11,526 |
| Change in accrued interest payable | 7,261 | (21,117) |
| Change in accrued interest receivable | 165 | 1,708 |
| Net realized and unrealized gains on investment securities | (8,953) | (2,097) |
| Gain on sale of portfolio | (3,917) | - |
| Gain on derivatives | (421) | (255) |
| Securitization gains on mortgage-backed securities | (91,533) | (80,051) |
| Amortization of fair value of employee stock options | 1,203 | 1,543 |
| Change in amounts payable to MBS and CMB holders | 32,683 | 50,883 |
| Other | 6,855 | (12,949) |
| Cash provided by operating activities | 164,771 | 121,898 |
| FINANCING ACTIVITIES | | |
| Net increase in deposits | 113,028 | 1,307,041 |
| Repurchase of shares | (8,524) | (4,665) |
| Exercise of stock options and stock appreciation rights | 4,149 | 5,278 |
| Dividends paid | (22,906) | (20,010) |
| Cash provided by financing activities | 85,747 | 1,287,644 |
| INVESTING ACTIVITIES | | |
| Activity in available for sale and held for trading securities | | |
| Purchases | (1,804,301) | (954,444) |
| Proceeds on sales | 1,409,583 | 767,516 |
| Proceeds on maturities | 503,873 | 135,615 |
| Activity in mortgages | | |
| Net increase | (5,454,266) | (3,569,541) |
| Proceeds from securitization | 5,091,160 | 2,550,007 |
| Change in securitization receivables | 54,799 | 41,454 |
| Net (increase) decrease in personal and credit card loans | (110,581) | 23,918 |
| Net increase in restricted cash | (28,190) | (42,465) |
| Purchase of capital assets | (2,989) | (2,181) |
| Purchase of intangible assets | (21,106) | (26,174) |
| Cash used in investing activities | (362,018) | (1,076,295) |
| Net (decrease) increase in unrestricted cash and cash equivalents | (111,500) | 333,247 |
| Cash and cash equivalents, beginning of year | (Note 3(a)) 866,069 | 532,822 |
| Cash and cash equivalents, end of year | (Note 3(a)) \$ 754,569 | \$ 866,069 |
| Supplemental disclosure of cash flow information | | |
| Amount of interest paid in year | \$ 181,109 | \$ 221,209 |
| Amount of income taxes paid in year | 42,114 | 45,506 |

See accompanying notes

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements of Home Capital Group Inc. (the "Company") have been prepared in accordance with Canadian generally accepted accounting principles (GAAP). The significant accounting policies used in the preparation of these consolidated financial statements are summarized below.

Use of Estimates

The preparation of consolidated financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the consolidated balance sheet date and the reported amounts of revenue and expenses during the reporting period. Key areas where management has made estimates include allowance for credit losses, securitization, fair values and impairment of financial instruments, goodwill and income tax. Actual results could differ from those estimates.

Principles of Consolidation

The consolidated financial statements include the assets, liabilities and results of operations of the Company and all of its subsidiaries, after the elimination of intercompany transactions and balances.

The Company also consolidates variable interest entities when it is the primary beneficiary. Under AcG-15, *Consolidation of Variable Interest Entities*, guidance is provided for applying consolidation principles to certain entities that are subject to control on a basis other than ownership of voting interests. Under this standard, the Company must consolidate these entities if it is the primary beneficiary that is, as a result of this investment, exposed to a majority of expected losses or is in a position to benefit from a majority of the returns.

Subsidiaries are defined as the corporations whose operations are controlled by the Company and are corporations in which the Company owns more than 50% of the voting shares. The subsidiaries included in the consolidated financial statements are Home Trust Company (Home Trust) and Payment Services Interactive Gateway Corp. (PSiGate) both of which are wholly owned.

Cash Resources

For the purposes of the consolidated statement of cash flows, cash and cash equivalents comprise balances with less than 90 days to maturity from the date of acquisition, including cash and deposits with regulated financial institutions, treasury bills and other eligible deposits. Cash and deposits are carried at fair value. Interest income is recognized in income on an accrual basis and, to the extent not received at year-end, recorded as a receivable in other assets on the consolidated balance sheet.

Restricted cash is held as collateral by a third party for the Company's securitization and interest rate swap transactions.

Cheques and Other Items in Transit

Cheques and other items in transit represent uncleared settlements with other regulated financial institutions and are recorded at cost.

Securities

Securities are classified as either held for trading or available for sale, based on management's intentions. On the settlement date, all securities are recognized at their fair value, which is normally the transaction price.

Held for trading securities are financial assets purchased for resale, generally within a short period of time and primarily held for liquidity purposes. Interest earned is included in other interest income. Held for trading securities are measured at fair value, using published bid prices, as at the consolidated balance sheet date. All realized and unrealized gains and losses are reported in income under non-interest income. Transaction costs are expensed as incurred. The Company has not elected under the fair value option to designate any financial asset or liability as held for trading.

Available for sale securities are financial assets purchased for longer-term investment that may be sold in response to or in anticipation of changes in market conditions. Dividends and interest earned are included in dividends from securities or other interest. Available for sale securities are measured at their fair value, using published bid prices, as at the consolidated balance sheet date. Unrealized gains and losses, net of related taxes, are included in accumulated other comprehensive income until the security is sold or an other than temporary impairment is recognized, at which time the cumulative loss is transferred to net income. The Company conducts a quarterly review to identify securities which have indicators of possible impairment. Factors considered in determining whether a loss is other than temporary include the length of time and extent to which fair value has been below cost, financial condition and near-term prospects of the issuer, and the likelihood for recovery. Transaction costs are generally capitalized.

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

Loans

Loans are recorded at amortized cost using the effective interest rate method. Interest income is allocated over the expected term of the loan by applying the effective interest rate to the carrying amount of the loan. The effective interest rate is the rate that exactly discounts estimated future cash receipts over the expected life of the loan. Origination revenues and costs are applied to the carrying amount of the loan.

Loans are carried net of the specific allowance for credit losses and any unearned income.

Interest income is accrued as earned until such time as the loan is recognized as impaired. At that time interest ceases to accrue and all previously accrued interest is reversed.

A loan is recognized as being impaired when the Company is no longer reasonably assured of the timely collection of the full amount of principal and interest. As a matter of practice, a loan is deemed to be impaired at the earlier of the date it has been specifically provided for or when it has been in arrears for 90 days. Residential mortgages guaranteed by the Government of Canada where payment is contractually past due 365 days are automatically placed on a non-accrual basis. Secured and unsecured credit card balances that have a payment that is contractually 180 days in arrears are written off. Equityline Visa credit card balances are measured on a basis consistent with mortgage loans.

When loans are classified as impaired, the book value of these loans is adjusted to their estimated realizable value based on the fair value of any security underlying the loan, net of any costs of realization, by totally or partially writing off the loan and/or establishing an allowance for loan losses.

An impaired loan is not returned to an accrual status unless all principal and interest payments are up to date and management is reasonably assured as to the recoverability of the loan.

Allowance for Credit Losses

An allowance for credit losses is maintained at an amount which, in management's opinion, is considered adequate to absorb all credit-related losses which have occurred in the portfolio whether or not detected at the year-end. Allowances are mainly related to loans but may also apply to other assets. The allowance consists of accumulated specific and general allowances, each of which is reviewed on a regular basis. The general allowance is deducted from the loans on the consolidated balance sheet.

Specific Allowances

Specific allowances are determined on an item-by-item basis and reflect the associated estimated credit loss. In the case of loans and Equityline Visa credit cards, the specific allowances are the amounts required to reduce the carrying value of an impaired loan to its estimated realizable amount. The fair value of the underlying security is used to estimate the realizable amount of the loan. The allowance is the difference between the loan's carrying value and its estimated realizable amount. For secured and unsecured credit cards, specific provisions are provided for arrears over 120 days.

General Allowances

General allowances are established to absorb credit losses on the aggregate exposures in each of the Company's business lines for which losses have been incurred but are not yet specifically identified on an item-by-item basis. The general allowance is based upon statistical analysis of past performance, level of allowance already in place and management's judgement. The general allowance, based on the historical loss experience, adjusted to reflect changes in the portfolios and credit policies, is applied to each pool of loans with common risk characteristics. This estimate includes consideration of economic and business conditions and management's judgement.

The amount of the provision for credit losses that is charged to the consolidated statement of income is the amount that is required to establish a balance in the allowance for credit losses account that the Company's management considers adequate to absorb all credit-related losses in its portfolio of balance sheet items, after charging amounts written off during the year, net of any recoveries, to the allowance for credit losses account.

Loan Securitization (Securitization Receivables)

The Company periodically transfers pools of mortgages to special purpose entities or trusts which, in turn, issue securities to investors. Mortgage loan securitization is part of the Company's liquidity and capital management strategies. These transfers are accounted for as sales when the Company surrenders control of the transferred assets and receives consideration other than the beneficial interest in the transferred assets. The securitization trusts have no recourse to the Company's other assets.

When such sales occur, the Company retains interest-only strips and servicing responsibilities for the assets sold. Gains or losses on these transactions are recognized as income and are dependent in part on the previous carrying amount of the financial assets involved in the transfer, allocated between the assets sold and the retained interests, based on their relative fair value at the date of transfer and net of transaction costs. Retained interests are classified as available for sale assets and are stated at their fair value with unrealized gains and losses reported in accumulated other comprehensive income. The fair value of the retained interests is estimated using discounted cash flow methodology and management's best estimates of key assumptions, such as prepayment rates, average term of assets sold and other factors that influence the value of the retained interests.

Retained interests are revalued quarterly to assess for other than temporary impairment.

Capital Assets

Capital assets, which are comprised of office furniture and equipment, computer equipment, software and leasehold improvements, are recorded at cost and amortized over their estimated useful lives on a declining balance basis at the following annual rates:

| | |
|--------------------------------|---------|
| Office furniture and equipment | 20% |
| Computer equipment | 30%-45% |

Application software is amortized on a straight-line basis over two years. Leasehold improvements are amortized on a straight-line basis over the remaining term of the leases.

Translation of Foreign Currencies

Assets and liabilities denominated in foreign currencies are translated into Canadian dollars at rates prevailing at the consolidated balance sheet date. Revenues and expenses denominated in foreign currencies are translated at the average exchange rates prevailing during the year. Realized and unrealized gains and losses on foreign currency transactions are included in fees and other income in the consolidated statements of income.

Goodwill and Intangible Assets

Goodwill and intangible assets are tested annually for impairment to ensure that their fair value is greater than or equal to book value. Any excess of book value over fair value is charged to income in the period in which the impairment is determined. It is management's belief that there is no impairment of goodwill or intangible assets as at December 31, 2010.

Intangible assets (customer contracts, lists acquired on acquisition and software development costs) are amortized on a straight-line basis over their useful lives. The Company capitalizes eligible development costs related to the development of its new core banking system. Amortization of these costs over its appropriate useful life will commence upon implementation.

Derivative Financial Instruments

The Company enters into non-trading derivative financial instruments as part of the mortgage securitization program. Non-trading derivatives entered into are carried at fair value in other assets or liabilities, on a net basis, with changes in fair value recorded in non-interest income on the consolidated statements of income.

During 2010 and 2009, the Company did not designate any non-trading derivatives for hedge accounting.

Deposits

Deposits are financial liabilities that are measured at cost using the effective interest rate method. Deposit origination costs are added to deposits on the consolidated balance sheet as incurred and amortized to interest expense over the term of the deposit.

Income Taxes

The Company follows the asset and liability method of accounting for income taxes, whereby future tax assets and liabilities are recognized for the expected future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the period in which those temporary differences are expected to be recovered or settled.

Future tax liabilities are included in other liabilities on the consolidated balance sheet.

Employee Future Benefits

The Company accrues its obligations under employee benefit plans, which include post-retirement plans (health costs). The cost of the post-retirement benefits earned by the affected employees is actuarially determined using the projected benefit method pro rated on service and management's best estimate of expected health care costs.

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

Stock-based Compensation Plans

The Company has three stock-based compensation plans, which are described in Notes 10 and 13.

The Company's Employee Stock Option Plan provides for the granting of stock options to certain employees and Directors of the Company. In some cases, stock appreciation rights are also granted in tandem with the stock option, providing the Company with, at its sole discretion, the alternative of settling the award in cash at an amount equal to the excess of the market price of the shares to which the option relates over the exercise price of the option. The Company accounts for stock options, including those with tandem stock appreciation rights, as equity-settled transactions where the fair value of options granted after January 1, 2003 is charged to salary expense over the option vesting period. The fair value of the options granted is determined using the Black-Scholes option pricing model using management's best estimates. Refer to Note 10 for the estimates applied.

With respect to options granted prior to January 1, 2003, the Company continues to apply the previous standards under which no compensation expense is recognized at the grant date and the consideration paid by the employees or Directors who exercise their stock options is credited to capital stock.

The Company offers a deferred share unit plan (DSU) which is open to Directors of the Company who annually elect to accept remuneration in the form of cash, cash and DSUs, or DSUs. Under the plan, the obligations for the DSUs are accrued quarterly based on the Directors' remuneration for the quarter. The obligations are periodically adjusted for fluctuations in the market price of the Company's common shares and allow for dividend equivalents. Changes in obligations under the plan are recorded as salary expenses in the consolidated statements of income with a corresponding increase in other liabilities on the consolidated balance sheets.

Under the Employee Share Purchase Plan, as described in Note 13, the Company's contribution is expensed when paid.

NOTE 2 FUTURE CHANGES IN ACCOUNTING POLICIES

International Financial Reporting Standards

The Canadian Institute of Chartered Accountants (CICA) will transition financial reporting for Canadian public entities to International Financial Reporting Standards (IFRS) effective for fiscal years beginning on or after January 1, 2011. The Company's 2011 quarterly and annual reports will include comparative 2010 financial results under IFRS.

NOTE 3 CASH RESOURCES AND SECURITIES
(a) Cash Resources

| (000s) | 2010 | 2009 |
|--|-------------------|-------------------|
| Deposits with regulated financial institutions | \$ 347,631 | \$ 866,069 |
| Treasury bills guaranteed by government | 406,938 | - |
| Cash and cash equivalents | 754,569 | 866,069 |
| Restricted cash ¹ | 92,255 | 64,065 |
| | \$ 846,824 | \$ 930,134 |

¹ Restricted cash includes a deposit of \$70.0 million (2009 - \$46.1 million) and \$22.3 million (2009 - \$18.0 million) held as collateral for the Company's securitization activities and the Company's interest rate swap transactions.

(b) Securities at Fair Value by Type and Remaining Term to Maturity

| (000s) | Within 1 Year | 1 to 3 Years | 3 to 5 Years | Over 5 Years | 2010 Total Fair Value | 2009 Total Fair Value |
|---|-------------------|-------------------|-------------------|------------------|-----------------------------|-----------------------------|
| Held for trading | | | | | | |
| Securities issued or guaranteed by Canada | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 99,938 |
| Available for sale | | | | | | |
| Securities issued or guaranteed by | | | | | | |
| Canada | 13,944 | 66,148 | 44,613 | - | 124,705 | 56,173 |
| Corporations | 76,021 | 20,631 | - | - | 96,652 | 194,085 |
| Equity securities | | | | | | |
| Common | 7,362 | - | - | - | 7,362 | 6,689 |
| Fixed rate preferred | 69,557 | 44,378 | 159,662 | 35,734 | 309,331 | 287,967 |
| Income trusts | 4,727 | - | - | - | 4,727 | 4,800 |
| Mutual funds | 1,115 | - | - | - | 1,115 | 945 |
| | \$ 172,726 | \$ 131,157 | \$ 204,275 | \$ 35,734 | \$ 543,892 | \$ 650,597 |

During 2010, on held for trading securities, the Company recognized in net income \$0.2 million (2009 - \$0.5 million) of interest and \$nil (2009 - \$nil) realized gains.

(c) Unrealized Gains and Losses on Available for Sale Securities

| (000s, except %) | Cost | Gross Unrealized Gains | Gross Unrealized Losses | 2010 Total Fair Value | Weighted- average Yield |
|---|-------------------|------------------------------|-------------------------------|-----------------------------|-------------------------------|
| Securities issued or guaranteed by | | | | | |
| Canada | \$ 124,838 | \$ - | \$ (133) | \$ 124,705 | 1.9% |
| Corporations | 96,522 | 130 | - | 96,652 | 1.8% |
| Equity securities | | | | | |
| Common | 7,049 | 611 | (298) | 7,362 | 2.1% |
| Fixed rate preferred | 303,049 | 7,631 | (1,349) | 309,331 | 5.0% |
| Income trusts | 5,185 | - | (458) | 4,727 | 5.1% |
| Mutual funds | 1,000 | 115 | - | 1,115 | - |
| | \$ 537,643 | \$ 8,487 | \$ (2,238) | \$ 543,892 | |

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

| | 2009 | | | | |
|------------------------------------|-------------------|------------------------------|-------------------------------|------------------------|-------------------------------|
| (000s, except %) | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Total Fair Value | Weighted- average Yield |
| Securities issued or guaranteed by | | | | | |
| Canada | \$ 56,170 | \$ 3 | \$ - | \$ 56,173 | 1.6% |
| Corporations | 194,120 | - | (35) | 194,085 | 1.3% |
| Equity securities | | | | | |
| Common | 6,329 | 891 | (531) | 6,689 | 2.5% |
| Fixed rate preferred | 279,862 | 13,038 | (4,933) | 287,967 | 5.4% |
| Income trusts | 2,483 | 2,317 | - | 4,800 | 5.0% |
| Mutual funds | 1,000 | - | (55) | 945 | - |
| | \$ 539,964 | \$ 16,249 | \$ (5,554) | \$ 550,659 | |

The above unrealized losses represent differences between the cost of a security and its current fair value. The Company does not consider these losses to be other than temporary, based on market conditions at December 31, 2010, and continues to regularly monitor these investments and market conditions.

For the year ended December 31, 2010, the Company determined that \$0.7 million (2009 - \$5.8 million) of unrealized losses on available for sale securities were other than temporary in nature. These losses were transferred into net income. These unrealized losses are not included in the table above.

NOTE 4 LOANS

(a) Loans by Geographic Region and Type (net of specific allowances for credit losses)

As at December 31

2010

| (000s, except %) | Residential Mortgages | Non-residential Mortgages | Personal and Credit Card Loans | Total | Percentage of Portfolio |
|---------------------|--------------------------|------------------------------|--------------------------------------|---------------------|----------------------------|
| British Columbia | \$ 303,458 | \$ 9,580 | \$ 15,921 | \$ 328,959 | 5.6% |
| Alberta | 297,544 | 31,813 | 39,090 | 368,447 | 6.3% |
| Ontario | 3,592,856 | 736,310 | 391,976 | 4,721,142 | 80.5% |
| Quebec | 154,793 | 34,710 | 1,482 | 190,985 | 3.3% |
| Atlantic provinces | 124,980 | 25,840 | 3,661 | 154,481 | 2.6% |
| Other | 96,499 | - | 1,209 | 97,708 | 1.7% |
| | \$ 4,570,130 | \$ 838,253 | \$ 453,339 | \$ 5,861,722 | 100.0% |
| As a % of portfolio | 78.0% | 14.3% | 7.7% | 100.0% | |

As at December 31

2009

| (000s, except %) | Residential Mortgages | Non-residential Mortgages | Personal and Credit Card Loans | Total | Percentage of Portfolio |
|---------------------|--------------------------|------------------------------|--------------------------------------|---------------------|----------------------------|
| British Columbia | \$ 476,425 | \$ 9,270 | \$ 22,617 | \$ 508,312 | 9.3% |
| Alberta | 364,050 | 76,424 | 54,209 | 494,683 | 9.0% |
| Ontario | 3,281,896 | 570,339 | 258,952 | 4,111,187 | 75.2% |
| Quebec | 131,776 | 31,660 | 1,594 | 165,030 | 3.0% |
| Atlantic provinces | 92,121 | 11,399 | 4,095 | 107,615 | 2.0% |
| Other | 70,929 | 9,333 | 1,451 | 81,713 | 1.5% |
| | \$ 4,417,197 | \$ 708,425 | \$ 342,918 | \$ 5,468,540 | 100.0% |
| As a % of portfolio | 80.8% | 12.9% | 6.3% | 100.0% | |

(b) Past Due Loans That Are Not Impaired

As at December 31

2010

| (000s) | Residential Mortgages | Non-residential Mortgages | Personal and Credit Card Loans | Total |
|--------------|--------------------------|------------------------------|--------------------------------------|------------|
| 1-30 days | \$ 108,842 | \$ 4,671 | \$ 4,706 | \$ 118,219 |
| 31-60 days | 26,027 | 1,022 | 1,922 | 28,971 |
| 61-90 days | 6,038 | - | 1,857 | 7,895 |
| Over 91 days | 7,080 | - | 1,384 | 8,464 |
| | \$ 147,987 | \$ 5,693 | \$ 9,869 | \$ 163,549 |

As at December 31

2009

| (000s) | Residential Mortgages | Non-residential Mortgages | Personal and Credit Card Loans | Total |
|--------------|--------------------------|------------------------------|--------------------------------------|------------|
| 1-30 days | \$ 134,925 | \$ 4,058 | \$ 5,204 | \$ 144,187 |
| 31-60 days | 36,149 | 1,910 | 1,428 | 39,487 |
| 61-90 days | 3,080 | - | 2,162 | 5,242 |
| Over 91 days | 8,911 | - | 749 | 9,660 |
| | \$ 183,065 | \$ 5,968 | \$ 9,543 | \$ 198,576 |

(c) Impaired Loans and Specific Allowances for Credit Losses

As at December 31

2010

| (000s) | Residential Mortgages | Non-residential Mortgages | Personal and Credit Card Loans | Total |
|--------------------------------|--------------------------|------------------------------|--------------------------------------|-----------|
| Gross amount of impaired loans | \$ 29,586 | \$ 2,295 | \$ 7,241 | \$ 39,122 |
| Specific allowances | (1,757) | - | (3,140) | (4,897) |
| | \$ 27,829 | \$ 2,295 | \$ 4,101 | \$ 34,225 |

As at December 31

2009

| (000s) | Residential Mortgages | Non-residential Mortgages | Personal and Credit Card Loans | Total |
|--------------------------------|--------------------------|------------------------------|--------------------------------------|-----------|
| Gross amount of impaired loans | \$ 41,621 | \$ 2,417 | \$ 4,847 | \$ 48,885 |
| Specific allowances | (1,483) | (135) | (961) | (2,579) |
| | \$ 40,138 | \$ 2,282 | \$ 3,886 | \$ 46,306 |

Included in the gross amount of impaired loans are foreclosed loans with an estimated realizable value of \$1.6 million (2009 - \$2.2 million).

(d) Collateral

The fair value of collateral held against mortgages is based on appraisals at the time a loan is originated. Appraisals are only updated should circumstances warrant it or if a mortgage becomes impaired. As at December 31, 2010, the total appraised value of the collateral for mortgages past due that are not impaired, as determined when the mortgages were originated, was \$380.8 million (2009 - \$361.7 million). For impaired mortgages, the total appraised value of collateral at December 31, 2010 was \$49.3 million (2009 - \$71.5 million).

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

(e) Allowance for Credit Losses

| For the year ended | | | | | 2010 |
|--------------------------------------|--------------------------|------------------------------|--------------------------------------|-----------|---------------|
| (000s) | Residential Mortgages | Non-residential Mortgages | Personal and Credit Card Loans | Total | |
| Specific allowances | | | | | |
| Balance at the beginning of the year | \$ 1,483 | \$ 135 | \$ 961 | \$ | 2,579 |
| Provisions for credit losses | 4,109 | (135) | 4,077 | \$ | 8,051 |
| Write-offs | (6,345) | - | (2,177) | \$ | (8,522) |
| Recoveries | 2,510 | - | 279 | \$ | 2,789 |
| | 1,757 | - | 3,140 | \$ | 4,897 |
| General allowance | | | | | |
| Balance at the beginning of the year | 19,948 | 4,398 | 3,447 | \$ | 27,793 |
| Provisions for credit losses | (3,649) | 4,959 | 50 | \$ | 1,360 |
| | 16,299 | 9,357 | 3,497 | \$ | 29,153 |
| Total allowance | \$ 18,056 | \$ 9,357 | \$ 6,637 | \$ | 34,050 |
| Total provision | \$ 460 | \$ 4,824 | \$ 4,127 | \$ | 9,411 |

| For the year ended | | | | | 2009 |
|--------------------------------------|--------------------------|------------------------------|--------------------------------------|-----------|---------------|
| (000s) | Residential Mortgages | Non-residential Mortgages | Personal and Credit Card Loans | Total | |
| Specific allowances | | | | | |
| Balance at the beginning of the year | \$ 2,379 | \$ - | \$ 547 | \$ | 2,926 |
| Provisions for credit losses | 6,650 | 135 | 2,125 | \$ | 8,910 |
| Write-offs | (8,822) | - | (1,913) | \$ | (10,735) |
| Recoveries | 1,276 | - | 202 | \$ | 1,478 |
| | 1,483 | 135 | 961 | \$ | 2,579 |
| General allowance | | | | | |
| Balance at the beginning of the year | 16,897 | 4,580 | 3,700 | \$ | 25,177 |
| Provisions for credit losses | 3,051 | (182) | (253) | \$ | 2,616 |
| | 19,948 | 4,398 | 3,447 | \$ | 27,793 |
| Total allowance | \$ 21,431 | \$ 4,533 | \$ 4,408 | \$ | 30,372 |
| Total provision | \$ 9,701 | \$ (47) | \$ 1,872 | \$ | 11,526 |

(f) Loan Maturities

| | | | | | | 2010 | 2009 |
|--|---------------------|---------------------|-------------------|-------------------|---------------------|---------------------|-----------|
| (000s) | Within 1 Year | 1 to 3 Years | 3 to 5 Years | Over 5 Years | Total Book Value | Total Book Value | |
| Residential mortgages | \$ 1,741,706 | \$ 2,001,641 | \$ 559,606 | \$ 267,177 | \$ 4,570,130 | \$ | 4,417,197 |
| Non-residential mortgages | 263,217 | 384,083 | 150,740 | 40,213 | 838,253 | \$ | 708,425 |
| Personal and credit card loans | 344,076 | 5,705 | 87,442 | 16,116 | 453,339 | \$ | 342,918 |
| | 2,348,999 | 2,391,429 | 797,788 | 323,506 | 5,861,722 | \$ | 5,468,540 |
| General allowance for credit losses | - | - | - | - | (29,153) | \$ | (27,793) |
| | \$ 2,348,999 | \$ 2,391,429 | \$ 797,788 | \$ 323,506 | \$ 5,832,569 | \$ | 5,440,747 |

(g) Sale of Loan Portfolio

During the year, the Company recognized a \$3.9 million gain on sale of a portfolio of individual water heater loans totalling \$19.5 million.

NOTE 5 LOAN SECURITIZATION (SECURITIZATION RECEIVABLES)

The Company's subsidiary, Home Trust, securitizes residential mortgage loans, and in these securitizations Home Trust retains interest-only strips and servicing responsibilities. The retained interests consist of Home Trust's rights to future cash flows arising after the investors in the special purpose entity have received the return for which they contracted. The investors and the special purpose entities have no recourse to other assets of either the Company or Home Trust for failure of debtors to pay when due.

During the year, Home Trust sold \$5.17 billion (2009 – \$2.60 billion) of mortgages in securitization transactions. As at December 31, 2010, the retained interest in the securitization receivable recorded on the consolidated balance sheet for securitization transactions totalled \$343.4 million (2009 – \$229.4 million). This value is subject to prepayment and interest rate risks on the transferred receivables. Since these loans are transferred on a serviced basis, Home Trust has a servicing liability of \$41.6 million (2009 – \$30.4 million) included in other liabilities.

Included in the above is participation in the Canada Mortgage Bond (CMB) program. Total mortgage receivables of \$3.18 billion (2009 – \$1.96 billion) were sold through the CMB program. The net gain on sale was \$36.7 million for the year (2009 – \$62.1 million). As at December 31, 2010, the securitization receivable includes \$243.7 million (2009 – \$187.5 million) for the CMB retained interest. A servicing liability of \$35.8 million (2009 – \$28.5 million) is included in other liabilities and relates to the Company's obligation to service the assets in the CMB program.

Mortgage payments, which have been collected and are payable to the National Housing Authority (NHA) trusts, as at December 31, 2010 totalled \$125.6 million (2009 – \$92.9 million) and are reported under other liabilities. There are no expected credit losses on the securitized mortgage assets as the mortgages are guaranteed by Canada Mortgage and Housing Corporation (CMHC), an agency of the federal government.

The impact of securitizations on the consolidated statement of income for the years ended December 31 is as follows:

| (000s) | 2010 | 2009 |
|---|-------------------|------------------|
| Net gain on sales of mortgages | \$ 98,684 | \$ 80,113 |
| Hedging cost | (7,151) | (62) |
| Amortization of servicing liability | 7,229 | 3,705 |
| Other securitization income (net of expenses) | 8,962 | 8,641 |
| | \$ 107,724 | \$ 92,397 |

The following table provides quantitative information about key assumptions in measuring retained interests at the date of securitization of residential mortgages securitized during the years ended December 31:

| | 2010 | 2009 |
|--------------------------------|-------|------|
| Prepayment rate | 14.4% | 7.1% |
| Discount rate | 1.9% | 2.7% |
| Excess spread | 1.6% | 1.9% |
| Weighted-average life in years | 4.2 | 5.0 |

There are no assumptions for expected credit losses as these mortgages are all insured.

The following table shows the impact on the fair value of the retained interest (level 3 financial instruments: see Note 17 for additional details) of using key economic assumptions and the sensitivity of the current fair value of residual cash flows to immediate 10% and 20% adverse changes in those assumptions:

| (000s, except % and number of years) | 2010 | 2009 |
|--|------------|------------|
| Carrying amount of retained interest | \$ 343,402 | \$ 229,418 |
| Weighted-average life in years | 4.6 | 4.7 |
| Prepayment rate | 15.3% | 7.7% |
| Impact on fair value of 10% adverse change | (4,401) | (3,401) |
| Impact on fair value of 20% adverse change | (8,639) | (5,781) |
| Residual cash flows discount rate | 2.0% | 2.7% |
| Impact on fair value of 10% adverse change | (1,467) | (2,487) |
| Impact on fair value of 20% adverse change | (2,922) | (3,845) |

There are no assumptions for expected credit losses as these mortgages are all insured.

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

The table below presents a reconciliation of the retained interest (level 3 financial instruments) for the years ended December 31, 2010 and 2009:

| (000s) | As at January 1, 2010 | Total Loss Recorded in OCI | Additions | Net Cash Flows | Other | As at December 31, 2010 |
|---------------------------|-----------------------------|----------------------------------|------------|-------------------|-----------|-------------------------------|
| Securitization receivable | \$ 229,418 | \$ (600) | \$ 193,362 | \$ (103,036) | \$ 24,258 | \$ 343,402 |

| (000s) | As at January 1, 2009 | Total Gain Recorded in OCI | Additions | Net Cash Flows | Other | As at December 31, 2009 |
|---------------------------|-----------------------------|----------------------------------|------------|-------------------|----------|-------------------------------|
| Securitization receivable | \$ 139,870 | \$ 1,692 | \$ 156,996 | \$ (72,290) | \$ 3,150 | \$ 229,418 |

The table below summarizes certain cash flows received from the securitization trusts:

| (000s) | 2010 | 2009 |
|---|--------------|--------------|
| Net proceeds from new securitizations | \$ 5,091,160 | \$ 2,550,007 |
| Net cash flows received on retained interests | 103,036 | 72,290 |

The table below summarizes quantitative information about the Company's loans:

| (000s) | 2010 | |
|---|------------------------|---|
| | Total Principal Amount | Principal Amount of Loans 61 or More Days Past Due |
| Total loans managed or securitized | \$ 14,028,255 | \$ 75,281 |
| Less mortgages securitized | 8,166,533 | 19,800 |
| Total loans reported on the consolidated balance sheet | \$ 5,861,722 | \$ 55,481 |

| (000s) | 2009 | |
|---|------------------------|---|
| | Total Principal Amount | Principal Amount of Loans 61 or More Days Past Due |
| Total loans managed or securitized | \$ 9,616,251 | \$ 101,628 |
| Less mortgages securitized | 4,147,711 | 37,841 |
| Total loans reported on the consolidated balance sheet | \$ 5,468,540 | \$ 63,787 |

NOTE 6 CAPITAL ASSETS

| (000s) | 2010 | | | 2009 |
|--------------------------------|-----------|-----------------------------|-------------------|-------------------|
| | Cost | Accumulated Amortization | Net Book Value | Net Book Value |
| Computer equipment | \$ 13,257 | \$ 11,002 | \$ 2,255 | \$ 1,868 |
| Software | 112 | 69 | 43 | 44 |
| Office furniture and equipment | 6,882 | 4,930 | 1,952 | 2,276 |
| Leasehold improvements | 3,366 | 2,722 | 644 | 675 |
| | \$ 23,617 | \$ 18,723 | \$ 4,894 | \$ 4,863 |

Amortization in respect of the above-noted capital assets for the year amounted to \$2.9 million (2009 - \$2.6 million).

| NOTE 7 | | OTHER ASSETS | |
|---|----|---------------------|------------|
| (000s) | | 2010 | 2009 |
| Accrued interest receivable | \$ | 25,988 | \$ 26,153 |
| Income taxes receivable | | 9,451 | - |
| Goodwill | | 15,752 | 15,752 |
| Intangible assets | | 47,917 | 26,811 |
| Other prepaid assets and deferred items | | 41,550 | 36,399 |
| | \$ | 140,658 | \$ 105,115 |

Intangible assets primarily comprise deferred costs capitalized for the development of the Company's new core banking system.

| NOTE 8 | | DEPOSITS | | | | | |
|------------------|----|--------------------------|----------------------|---------------------|---------------------|---------------------|--------------|
| | | | | | 2010 | 2009 | |
| (000s, except %) | | Payable on Demand | Within 1 Year | 1 to 3 Years | 3 to 5 Years | Total | Total |
| Individuals | \$ | 50,359 | \$ 3,407,337 | \$ 2,388,347 | \$ 613,291 | \$ 6,459,334 | \$ 6,370,564 |
| Businesses | | - | 26,872 | 18,181 | 18,463 | 63,516 | 39,258 |
| | \$ | 50,359 | \$ 3,434,209 | \$ 2,406,528 | \$ 631,754 | \$ 6,522,850 | \$ 6,409,822 |
| Effective yield | | - | 2.4% | 3.3% | 3.6% | 2.8% | 3.0% |

| NOTE 9 | | OTHER LIABILITIES | |
|---|----|--------------------------|------------|
| (000s) | | 2010 | 2009 |
| Accrued interest payable | \$ | 145,759 | \$ 138,498 |
| Dividends payable | | 6,236 | 5,901 |
| Future income taxes (Note 12) | | 88,562 | 57,559 |
| Securitization servicing liability (Note 5) | | 41,594 | 30,389 |
| Payable to MBS and CMB holders (Note 5) | | 125,579 | 92,896 |
| Other, including accounts payable and accrued liabilities | | 34,138 | 30,904 |
| | \$ | 441,868 | \$ 356,147 |

Included in Other is a liability for employee future benefits in the amount of \$133 thousand (2009 - \$152 thousand).

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

NOTE 10 CAPITAL

(a) Authorized

An unlimited number of common shares with no par value.

An unlimited number of preferred shares, issuable in series, to be designated as senior preferred shares.

An unlimited number of preferred shares, issuable in series, to be designated as junior preferred shares.

(b) Issued and Outstanding

| (000s) | 2010 | | 2009 | |
|-----------------------------|------------------|------------------|------------------|------------------|
| | Number of Shares | Book Value | Number of Shares | Book Value |
| Common shares | | | | |
| Balance, beginning of year | 34,713 | \$ 45,396 | 34,434 | \$ 39,094 |
| Options exercised | 130 | 5,309 | 445 | 6,498 |
| Repurchase of shares | (197) | (278) | (166) | (196) |
| Balance, end of year | 34,646 | \$ 50,427 | 34,713 | \$ 45,396 |

(c) Normal Course Issuer Bid

On August 30, 2010, the Company filed a Normal Course Issuer Bid which allowed it to purchase over a 12-month period, beginning September 1, 2010, up to 10% of the public float outstanding on August 30, 2010.

On July 29, 2009, the Company filed a Normal Course Issuer Bid which allowed it to purchase over a 12-month period, beginning August 1, 2009, up to 10% of the public float outstanding on July 29, 2009.

During the year, 197,700 (2009 – 165,400) common shares were purchased for \$8.5 million (2009 – \$4.7 million). The purchase price of shares acquired through the Normal Course Issuer Bid is allocated between capital stock and retained earnings. The cost of the common shares was reduced by \$0.3 million in 2010 (2009 – \$0.2 million). The balance of the purchase price of \$8.2 million (2009 – \$4.5 million) was charged to retained earnings.

(d) Stock Options

The details and changes in the issued and outstanding options are as follows:

| (000s, except exercise price and number of years) | 2010 | | 2009 | |
|---|-------------------|---------------------------------|-------------------|---------------------------------|
| | Number of Options | Weighted-average Exercise Price | Number of Options | Weighted-average Exercise Price |
| Outstanding, beginning of year | 925 | \$ 31.32 | 1,407 | \$ 25.08 |
| Issued | 343 | 47.82 | 168 | 30.12 |
| Exercised | (147) | 34.17 | (445) | 11.86 |
| Cancelled | (55) | 34.66 | (205) | 29.76 |
| Outstanding, end of year | 1,066 | \$ 36.07 | 925 | \$ 31.32 |
| Exercisable at year-end | 421 | \$ 33.06 | 458 | \$ 32.84 |
| Weighted-average term to maturity in years | | 5.9 | | 3.8 |

The Company's stock option plan was approved by the shareholders of the Company on December 31, 1986. The plan was amended, effective May 29, 2002, to conform to the Toronto Stock Exchange's Revised Policy on Listed Company Share Incentive Arrangements. As at December 31, 2010, the maximum number of common shares that may be issued was 4,585,198, representing approximately 13.2% of the aggregate number of common shares. The exercise price of the options is fixed by the Board of Directors (the Board) at the time of issuance at the market price of such shares, subject to all applicable regulatory requirements. The market price per share must not be less than the weighted-average price at which the common shares of the Company trade on the Toronto Stock Exchange during the two trading days immediately preceding the date on which the option is approved by the Board. The exercise period of any option is limited to a period of seven years from the date of grant of the option. The period within which an option or portion thereof may be exercised by a participant is determined in each case by the Board.

During the year, the Company approved an amendment to the employee stock option plan to provide stock appreciation rights which allow cash settlement of vested stock options, at the Company's discretion. During the year, 23,750 options were settled in cash for \$0.3 million (2009 – \$nil). The Company does not anticipate additional cash settlement except in isolated circumstances.

As at December 31, 2010, stock options outstanding to acquire common shares were as follows:

| | Stock Options Outstanding | Stock Options Exercisable | Exercise Price per Share | Expiry Date |
|---------------------------|------------------------------|------------------------------|-----------------------------|-------------|
| Options granted to | | | | |
| Directors | 100,000 | 75,000 | \$ 34.51 ² | 02/14/2012 |
| | 20,000 | 15,000 | 41.29 ² | 12/07/2014 |
| | 20,000 | 5,000 | 16.27 ³ | 12/08/2015 |
| | 25,000 | - | 47.92 ⁴ | 12/01/2017 |
| | 165,000 | 95,000 | | |
| Employees | 85,000 | 85,000 | 27.89 ¹ | 10/25/2011 |
| | 45,000 | 33,750 | 27.71 ¹ | 12/01/2011 |
| | 50,000 | 37,500 | 34.51 ² | 02/14/2012 |
| | 20,000 | 10,000 | 33.76 ² | 03/07/2014 |
| | 165,000 | 123,750 | 41.29 ² | 12/07/2014 |
| | 145,000 | 36,250 | 16.27 ³ | 12/08/2015 |
| | 25,000 | - | 17.06 ⁴ | 02/12/2016 |
| | 15,000 | - | 31.87 ⁴ | 05/05/2016 |
| | 10,000 | - | 40.70 ⁴ | 11/03/2016 |
| | 22,500 | - | 41.06 ⁴ | 12/02/2016 |
| | 10,000 | - | 44.63 ⁵ | 08/04/2017 |
| | 308,000 | - | 47.92 ⁵ | 12/01/2017 |
| | 900,500 | 326,250 | | |
| | 1,065,500 | 421,250 | \$ 33.06 | |

¹ In 2006, the Company granted certain employees the right to receive stock options if certain performance criteria were met. As at December 31, 2010, four levels of performance had been met for 85,000 options and three levels of performance had been met for 45,000 options. As a result, 100% and 75%, respectively, of these contingently assumable options have been included in the computation of diluted income per common share.

² In 2007, the Company granted certain employees the right to receive stock options if certain performance criteria were met. As at December 31, 2010, three levels of performance had been met for 335,000 options and two levels of performance had been met for 20,000 options. As a result, 75% and 50%, respectively, of these contingently assumable options have been included in the computation of diluted income per common share.

³ In 2008, the Company granted certain employees the right to receive stock options if certain performance criteria were met. As at December 31, 2010, one level of performance had been met. As a result, 25% of these contingently assumable options have been included in the computation of diluted income per common share.

⁴ In 2009, the Company granted certain employees the right to receive stock options if certain performance criteria were met. As at December 31, 2010, none of the performance criteria had been met. As a result, the contingently assumable options have not been included in the computation of diluted income per common share.

⁵ In 2010, the Company granted certain employees the right to receive stock options if certain performance criteria were met. As at December 31, 2010, none of the performance criteria had been met. As a result, the contingently assumable options have not been included in the computation of diluted income per common share.

(e) Fair Value Compensation of Stock Options

The Company determines the fair value of options granted using the Black-Scholes option pricing model. The fair value of the options granted during the year ended December 31, 2010 was \$16.61 for the December 2010 issue and \$17.85 for the August 2010 issue. The weighted-average fair value of the options granted during the year ended December 31, 2009 was \$14.55 for the December 2009 issue.

The following weighted-average assumptions were used to determine the fair value of the options on the date of grant:

| | December 2010 | August 2010 | December 2009 | November 2009 | May 2009 | February 2009 |
|--|------------------|----------------|------------------|------------------|-------------|------------------|
| Expected dividend yield | 1.39% | 1.11% | 1.54% | 1.40% | 1.62% | 2.51% |
| Expected share price volatility | 36.5% | 36.9% | 38.0% | 36.5% | 36.1% | 32.9% |
| Risk-free rate of return | 2.72% | 2.58% | 2.72% | 2.95% | 2.26% | 2.28% |
| Expected period until exercise in years | 6.0 | 7.0 | 6.0 | 7.0 | 7.0 | 7.0 |

For options granted after January 1, 2003, the Company determines the fair value of stock options on their grant date and records this amount as compensation expense over the period that the stock options vest, with a corresponding increase to contributed surplus. When these stock options are exercised, the Company records the amount of proceeds, together with the amount recorded in contributed surplus, in capital stock. Employee compensation expense increased by \$1.2 million (2009 - \$1.5 million) and net income decreased by the same amount with respect to options granted during the year.

Notes to Consolidated Financial Statements

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The Company does not record any compensation expense for stock options granted prior to January 1, 2003. When these stock options are exercised, the Company will include the amount of proceeds in capital stock. If the Company had recorded compensation expense for such options based on their fair value, there would have been no impact on 2010 and 2009 net income and income per share as these options are now fully vested.

(f) Deferred Share Units

The Company grants deferred share units (DSUs) to Directors of the Company. Under the plan, the Directors may annually elect to accept remuneration in the form of cash, cash and DSUs or DSUs prior to the beginning of the year. DSUs earn dividend equivalents in the form of additional DSUs at the same rate as dividends on common shares. The participant is not allowed to settle the DSUs until retirement or termination of directorship. The cash value of the DSUs is equivalent to the market value of common shares when settlement takes place. The value of the DSUs liability as at December 31, 2010, was \$0.43 million (2009 – \$0.27 million).

As of December 31, 2010, there were 9,670 DSUs available for grant under the plan. Of the DSUs issued, 9,670 DSUs remained outstanding at December 31, 2010.

(g) Income per Common Share ^(000s)

Basic income per common share is determined as net income for the year divided by the average number of common shares outstanding of 34,697 (2009 – 34,450).

Diluted income per common share is determined as net income for the year divided by the average number of common shares outstanding of 34,697 (2009 – 34,450) plus the stock options potentially exercisable, as determined under the treasury stock method, of 79 (2009 – 345) for a total of 34,776 (2009 – 34,795) diluted common shares.

(h) Capital Management

The Company has a capital management policy which governs the quantity and quality of capital held. The objective of the policy is to meet regulatory capital requirements, while also providing a sufficient return to investors. The Risk and Capital Committee and the Board of Directors annually review the policy and monitor compliance with the policy on a quarterly basis.

The Company's subsidiary, Home Trust, is subject to the regulatory capital requirements governed by the Office of the Superintendent of Financial Institutions Canada (OSFI). These requirements are consistent with international standards (Basel II) set by the Bank for International Settlements. Under Basel II, Home Trust follows the Standardized Approach for calculating credit risk and the Basic Indicator Approach for operational risk.

The regulatory capital position of Home Trust was as follows:

| (000s, except ratios and multiple) | 2010 | 2009 |
|------------------------------------|------------|------------|
| Regulatory capital | | |
| Tier 1 | \$ 682,978 | \$ 530,256 |
| Total | 731,676 | 581,036 |
| Regulatory ratios | | |
| Tier 1 | 18.1% | 16.4% |
| Total | 19.4% | 18.0% |
| Assets to capital multiple | 10.5 | 12.7 |

Under Basel II, OSFI considers a financial institution to be well capitalized if it maintains a Tier 1 capital ratio of 7% and a Total capital ratio of 10%. Home Trust is in compliance with the OSFI capital guidelines.

NOTE 11 ACCUMULATED OTHER COMPREHENSIVE INCOME

The components comprising the accumulated other comprehensive income are:

| (000s) | 2010 | 2009 |
|--|-----------|-----------|
| Unrealized gains on: | | |
| Available for sale securities | \$ 6,249 | \$ 10,695 |
| Income tax expense | (1,706) | (2,733) |
| | 4,543 | 7,962 |
| Unrealized gains on: | | |
| Securitization receivables | 19,172 | 19,772 |
| Income tax expense | (4,986) | (6,466) |
| | 14,186 | 13,306 |
| Accumulated other comprehensive income | \$ 18,729 | \$ 21,268 |

NOTE 12 INCOME TAXES**(a) Components of the Provision for Income Taxes**

| (000s) | 2010 | 2009 |
|-----------------------------|-----------|-----------|
| Current income taxes | | |
| Federal | \$ 20,564 | \$ 16,106 |
| Provincial | 14,667 | 11,719 |
| | 35,231 | 27,825 |
| Future income taxes | | |
| Federal | 15,201 | 15,529 |
| Provincial | 10,841 | 11,112 |
| | 26,042 | 26,641 |
| | \$ 61,273 | \$ 54,466 |

(b) Reconciliation of Income Taxes

The combined federal and provincial income tax rate varies each year according to changes in the statutory tax rate imposed by the federal and provincial governments. The effective rate of income tax in the consolidated statement of income is different from the combined federal and provincial income tax rate of 30.8% (2009 – 32.7%).

| (000s) | 2010 | 2009 |
|---|------------|------------|
| Income before income taxes | \$ 242,217 | \$ 198,959 |
| Income taxes at statutory combined federal and provincial income tax rate | \$ 74,719 | \$ 65,082 |
| Increase (decrease) in income taxes resulting from: | | |
| Tax-exempt income | (5,473) | (5,657) |
| Non-deductible expenses | 468 | 1,792 |
| Future tax rate changes | (7,056) | (9,762) |
| Other | (1,385) | 3,011 |
| | \$ 61,273 | \$ 54,466 |

Capital losses totalling \$2.8 million are available to reduce capital gains in future years. The future tax benefits arising from application of these losses have not been reflected in the consolidated statements of income and changes in shareholders' equity.

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(c) Sources of Future Income Tax Assets and Liabilities

| (000s) | 2010 | 2009 |
|--|------------------|------------------|
| Future income tax assets | | |
| Allowance for credit losses | \$ 7,781 | \$ 7,549 |
| Deferred commitment fees and unearned income | 4,393 | 3,213 |
| | 12,174 | 10,762 |
| Future income tax liabilities | | |
| Deferred agent commissions and other charges | 21,204 | 18,761 |
| Mortgage-backed securities receivable | 79,532 | 49,560 |
| | 100,736 | 68,321 |
| Net future income tax liability | \$ 88,562 | \$ 57,559 |

NOTE 13 EMPLOYEE BENEFITS

(a) Employee Share Purchase Plan

Effective January 1, 2001, qualifying employees of Home Trust have the ability to purchase shares in the Company. Under the Employee Share Purchase Plan, qualifying employees can choose each year to have up to 10% of their annual base earnings withheld to purchase common shares. The Company matches 50% of the employees' contribution amount. All contributions are used by the plan's trustee to purchase the common shares during each pay period in the open market. The Company's contributions are fully vested immediately. The Company's contributions are expensed as paid and totalled \$0.6 million for 2010 (2009 – \$0.5 million).

(b) Employee Retirement Savings Plan

During the year ended December 31, 2010, Home Trust contributed \$0.6 million (2009 – \$0.7 million) to the employee group registered retirement savings plan.

NOTE 14 COMMITMENTS AND CONTINGENCIES

(a) Lease Commitments

Contractual minimum obligations in respect of premises and equipment leases at December 31, 2010 are as follows:

| (000s) | 2010 | 2009 |
|---------------------|------------------|----------|
| 2011 | \$ 3,989 | 3,064 |
| 2012 | | 2,413 |
| 2013 | | 2,120 |
| 2014 | | 1,742 |
| 2015 | | - |
| 2016 and thereafter | | - |
| | \$ 13,328 | |
| (000s) | 2010 | 2009 |
| Rent paid | \$ 4,696 | \$ 4,224 |

(b) Credit Commitments

Outstanding commitments for funding on mortgages amounted to \$458.8 million as at December 31, 2010 (2009 – \$553.4 million). Commitments for loans remain open for various dates through November 2011. The average rate on mortgage commitments is 4.65% (2009 – 3.82%).

The Company also has contractual commitments to extend credit to its clients for its credit card products. The contractual commitment for this product represents the maximum potential credit risk, assuming the contractual amount is fully utilized and the client defaults and collection efforts are unsuccessful. At December 31, 2010, these contractual commitments in aggregate were \$416.4 million (2009 – \$357.5 million) of which \$76.5 million (2009 – \$52.8 million) has not been drawn by customers. In addition, outstanding commitments for new Equityline Visa accounts were \$5.1 million at December 31, 2010 (2009 – \$2.9 million).

These amounts in aggregate are not indicative of future cash requirements. Management does not expect any material adverse consequence to the Company's financial position to result from these commitments. Secured credit cards have spending limits restricted by collateral held by the Company.

(c) Directors' and Officers' Indemnification

The Company indemnifies Directors and officers, to the extent permitted by law, against certain claims that may be made against them as a result of their being, or having been, Directors and officers at the request of the Company. The nature of this indemnification prevents the Company from making a reasonable estimate of the maximum potential amount the Company could be required to pay to third parties. Management believes that the likelihood that the Company would incur a significant liability under these indemnifications is remote. The Company has purchased Directors' and officers' liability insurance.

NOTE 15 DERIVATIVE FINANCIAL INSTRUMENTS

In the normal course of business, the Company enters into contracts and commitments in order to protect itself against the risk of fluctuations in interest rates.

For example, the Company uses bond forward contracts to hedge the economic value exposure of movements in interest rates between the time that the mortgages are committed and the time the mortgages are securitized (these mortgages qualify for government insurance). The intent of the bond forward contract is to have fair value movements offset the fair value movements in the pool of mortgages over the period in which the fixed rate pool may be exposed to movements in interest rates, generally 60 to 150 days. During the year, the Company unwound \$1.71 billion in bond forward contracts, realizing a loss of \$7.2 million. This realized loss is included in the consolidated statements of income through securitization income. The table below includes bond forwards that remain outstanding at the end of the reporting period.

Additionally, the Company participates in the CMB program sponsored by CMHC. Under this program, the Company sells amortizing mortgage-backed securities (MBS) pools to Canada Housing Trust which finances the purchase by issuing a bullet CMB. Under this program, for fixed rate mortgage pools the Company manages the cash flow mismatch and reinvestment risk between the amortizing MBS pool and the bullet CMB. To manage the cash flow mismatch on fixed rate mortgage pools, the Company enters into seller swaps where the Company pays the fixed interest payments on the CMB, and receives the total return on the amortizing MBS pool. As well, the Company enters into accreting hedge swaps to manage the reinvestment risk between providing additional amortizing MBS pools and the bullet CMB. The Company also enters into seller swaps for variable rate CMBs, where the Company pays the variable CMB rate and receives the variable rate total return on the amortizing variable rate MBS. The Company does not enter into accreting hedge swaps for the variable rate CMB.

Additionally, the Company may utilize variable rate MBS pools in fixed rate CMB issues. In these cases, the Company remains obligated to enter into a seller swap, but also may hedge the interest rate risk between the variable rate MBS and the fixed rate CMB coupon by entering into a fixed notional, pay-variable, receive-fixed interest rate swap (hedge swap).

The Company may also from time to time enter into interest rate swaps to manage the interest rate risk that may emerge over time between the seller and the accreting hedge swaps described above. At December 31, 2010, the total notional value of these interest rate swaps was \$75.0 million. The interest swap had a negative fair value of \$2.0 million at December 31, 2010. There were no similar positions at December 31, 2009.

The fair value of the swap and bond forward contracts are included in other assets or other liabilities in the consolidated balance sheet with changes in fair value included in (loss) or gain on derivatives in the consolidated statement of income.

The swap transactions described above did not qualify for hedge accounting and therefore were accounted for on a mark-to-market basis, with changes in the fair value of the swap being recognized in income.

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The following tables summarize the Company's derivative holdings as at December 31, 2010 and 2009.

| | | | | | | 2010 |
|--|---------------------|--------------------------|--------------------------|-----------------------|-----------------------|------|
| (000s) | Notional Amount | Current Replacement Cost | Credit Equivalent Amount | Risk-weighted Balance | Net Fair Market Value | |
| Interest rate swaps¹ | | | | | | |
| Maturing in 2011 | \$ 138,590 | \$ 752 | \$ 752 | \$ 150 | \$ (905) | |
| Maturing in 2012 | 233,645 | 3,497 | 3,720 | 744 | 42 | |
| Maturing in 2013 | 1,108,440 | 8,246 | 8,903 | 1,780 | (1,078) | |
| Maturing in 2014 | 1,418,441 | 6,155 | 7,363 | 1,473 | (3,049) | |
| Maturing in 2015 | 2,634,908 | 17,316 | 26,857 | 5,371 | 9,604 | |
| Maturing in 2016 | 259,421 | 3,159 | 7,050 | 1,410 | 3,104 | |
| Maturing in 2018 | 238,456 | 52 | 75 | 15 | (3,258) | |
| Maturing in 2020 | 500,678 | 2,613 | 3,888 | 778 | (8,893) | |
| | \$ 6,532,579 | \$ 41,790 | \$ 58,608 | \$ 11,721 | \$ (4,433) | |
| Bonds² | | | | | | |
| Maturing in 2015 | \$ 36,300 | \$ 44 | \$ 104 | \$ 21 | \$ (48) | |
| Maturing in 2016 | 75,000 | - | - | - | (207) | |
| Maturing in 2020 | 140,900 | 289 | 1,094 | 219 | (474) | |
| | \$ 252,200 | \$ 333 | \$ 1,198 | \$ 240 | \$ (729) | |
| | | | | | | 2009 |
| (000s) | Notional Amount | Current Replacement Cost | Credit Equivalent Amount | Risk-weighted Balance | Net Fair Market Value | |
| Interest rate swaps¹ | | | | | | |
| Maturing in 2011 | \$ 124,870 | \$ 1,037 | \$ 1,130 | \$ 226 | \$ (28) | |
| Maturing in 2012 | 214,716 | 3,797 | 4,252 | 850 | 1,718 | |
| Maturing in 2013 | 1,044,775 | 7,605 | 8,995 | 1,799 | 1,560 | |
| Maturing in 2014 | 1,326,383 | 6,571 | 10,157 | 2,032 | (1,918) | |
| Maturing in 2018 | 234,936 | 41 | 1,446 | 289 | (3,796) | |
| Maturing in 2020 | 256,562 | - | - | - | (8,193) | |
| | \$ 3,202,242 | \$ 19,051 | \$ 25,980 | \$ 5,196 | \$ (10,657) | |
| Bonds² | | | | | | |
| Maturing in 2014 | \$ 17,200 | \$ 307 | \$ 393 | \$ 79 | \$ 307 | |
| Maturing in 2015 | 70,000 | 327 | 852 | 170 | 312 | |
| Maturing in 2018 | 74,700 | 1,459 | 2,580 | 516 | 1,459 | |
| Maturing in 2020 | 21,900 | 359 | 687 | 137 | 359 | |
| | \$ 183,800 | \$ 2,452 | \$ 4,512 | \$ 902 | \$ 2,437 | |

¹ Interest rate swaps include CMB interest rate swaps and additional interest rate swaps the Company enters into to manage the reinvestment risk of the CMB program.

² The term of the bond forward contracts is based on the term of the underlying bonds.

The following terms are used in the above tables: "notional amount" represents the amount to which a rate or price is applied in order to calculate the amount of cash that must be exchanged under the contract; "current replacement cost" represents the cost of replacing the contract which has a positive fair value using current market rates; "credit equivalent amount" is calculated using OSFI factors and represents the total replacement cost and the potential future credit exposure, if the counterparty defaults; "risk-weighted balance" represents the credit risk equivalent, weighted based on the creditworthiness of the counterparty, as prescribed by OSFI; and "net fair market value" represents the net value of the contracts using current interest rates.

In the following table, CMB interest rate swaps with a fair value of \$(19.8) million (2009 – \$(10.3) million) that are required for participation in the CMB program have fair values derived from inputs which the Company considers to be non-observable (level 3 financial instruments). The effect of changing one or more of the assumptions used to fair value these swaps to reasonably possible alternatives would impact net income as shown below:

| (000s) | 2010 | 2009 |
|---|-------------|-------------|
| Fair value of CMB interest rate swaps (seller swaps – level 3 financial instrument: see Note 17 for additional details) | \$ (19,797) | \$ (10,307) |
| Parallel shift in discount rate | | |
| Impact on fair value of 1% decrease | (25,844) | (24,374) |
| Impact on fair value of 1% increase | 24,823 | 22,486 |
| Prepayment rate | | |
| Impact on fair value of 5% decrease | (115) | (1,157) |
| Impact on fair value of 5% increase | 453 | 813 |

The table below presents a reconciliation of the CMB interest rate swaps for the years ended December 31, 2010 and 2009:

| (000s) | As at January 1, 2010 | Total Gain or Loss Recorded in Income Statement Excluding Net Settlements | Additions | Net Settlements Recorded in Income Statement | As at December 31, 2010 |
|--------------------------------------|-----------------------------|---|-----------|--|-------------------------------|
| CMB interest rate swap (seller swap) | \$ (10,307) | \$ (16,641) | \$ - | \$ 7,151 | \$ (19,797) |

| (000s) | As at January 1, 2009 | Total Gain or Loss Recorded in Income Statement Excluding Net Settlements | Additions | Net Settlements Recorded in Income Statement | As at December 31, 2009 |
|--------------------------------------|-----------------------------|---|-----------|--|-------------------------------|
| CMB interest rate swap (seller swap) | \$ (20,646) | \$ 7,682 | \$ - | \$ 2,657 | \$ (10,307) |

Total gain (loss) and net settlements on CMB interest rate swaps are recorded in the consolidated statement of income under securitization income and net realized and unrealized gain on derivatives.

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NOTE 16 INTEREST RATE SENSITIVITY

The Company is exposed to interest rate risk as a result of a difference, or gap, between the maturity or repricing date of interest-sensitive assets and liabilities. The following tables show the gap position at December 31, 2010 and 2009 for selected period intervals. Figures in parentheses represent an excess of liabilities over assets or a negative gap position.

This schedule reflects the contractual maturities of both assets and liabilities, adjusted for assumptions regarding the effective change in the maturity date as a result of a mortgage becoming impaired and for credit commitments and derivatives.

Based on the current interest rate gap position at December 31, 2010, the Company estimates that a 100 basis point decrease in interest rates would decrease net interest income after tax and net present value of shareholders' equity over the next 12 months by \$9.3 million and \$7.9 million, respectively. A 100 basis point increase in interest rates would increase net interest income after tax and net present value of shareholders' equity over the next 12 months by \$9.3 million and \$7.6 million, respectively.

2010

| (000s, except %) | Floating | 0 to 3 Months | 3 to 6 Months | 6 to 12 Months | 1 to 3 Years | Over 3 Years | Non-Interest-Sensitive | Total |
|---|------------------|---------------------|---------------------|---------------------|---------------------|---------------------|------------------------|---------------------|
| Assets | | | | | | | | |
| Cash resources | \$ 82,211 | \$ 690,986 | \$ - | \$ 71,330 | \$ 2,297 | \$ - | \$ - | \$ 846,824 |
| Weighted-average interest rate | 1.0% | 1.0% | - | 1.2% | 0.9% | - | - | 1.0% |
| Securities | - | 55,785 | 38,759 | 78,181 | 131,156 | 240,011 | - | 543,892 |
| Weighted-average interest rate | - | 2.5% | 3.1% | 3.2% | 3.1% | 4.8% | - | 3.8% |
| Loans | - | 1,021,027 | 381,285 | 1,301,657 | 2,181,716 | 913,556 | 33,328 | 5,832,569 |
| Weighted-average interest rate | - | 6.5% | 6.5% | 6.0% | 5.8% | 5.7% | - | 6.0% |
| Other assets | - | - | - | - | - | - | 488,954 | 488,954 |
| Weighted-average interest rate | - | - | - | - | - | - | - | - |
| Total | \$ 82,211 | \$ 1,767,798 | \$ 420,044 | \$ 1,451,168 | \$ 2,315,169 | \$ 1,153,567 | \$ 522,282 | \$ 7,712,239 |
| Weighted-average interest rate | 1.0% | 4.2% | 6.2% | 5.6% | 5.6% | 5.5% | - | 4.9% |
| Liabilities and shareholders' equity | | | | | | | | |
| Deposits payable on demand | \$ 6 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 50,353 | \$ 50,359 |
| Weighted-average interest rate | - | - | - | - | - | - | - | - |
| Deposits payable on a fixed date | - | 462,018 | 928,636 | 2,031,418 | 2,406,527 | 631,754 | 12,138 | 6,472,491 |
| Weighted-average interest rate | - | 2.6% | 2.4% | 2.3% | 3.3% | 3.6% | - | 2.9% |
| Other liabilities | - | - | - | - | - | - | 447,109 | 447,109 |
| Weighted-average interest rate | - | - | - | - | - | - | - | - |
| Shareholders' equity | - | - | - | - | - | - | 742,280 | 742,280 |
| Weighted-average interest rate | - | - | - | - | - | - | - | - |
| Total | \$ 6 | \$ 462,018 | \$ 928,636 | \$ 2,031,418 | \$ 2,406,527 | \$ 631,754 | \$ 1,251,880 | \$ 7,712,239 |
| Weighted-average interest rate | - | 2.6% | 2.4% | 2.3% | 3.3% | 3.6% | - | 2.4% |
| | \$ 82,205 | \$ 1,305,780 | \$ (508,592) | \$ (580,250) | \$ (91,358) | \$ 521,813 | \$ (729,598) | \$ - |
| Credit commitments and derivatives | - | (411,111) | 7,216 | 9,192 | 179,836 | 214,867 | - | - |
| Weighted-average interest rate | - | 12.6% | 9.4% | 5.8% | 5.2% | 3.5% | - | - |
| Interest rate sensitivity gap | \$ 82,205 | \$ 894,669 | \$ (501,376) | \$ (571,058) | \$ 88,478 | \$ 736,680 | \$ (729,598) | \$ - |
| Cumulative gap | \$ 82,205 | \$ 976,874 | \$ 475,498 | \$ (95,560) | \$ (7,082) | \$ 729,598 | \$ - | \$ - |

| (000s, except %) | Floating | 0 to 3 Months | 3 to 6 Months | 6 to 12 Months | 1 to 3 Years | Over 3 Years | Non-Interest-Sensitive | Total |
|---|------------------|---------------------|---------------------|-----------------------|---------------------|---------------------|------------------------|---------------------|
| Assets | | | | | | | | |
| Cash resources | \$ 68,941 | \$ 815,093 | \$ - | \$ 46,100 | \$ - | \$ - | \$ - | \$ 930,134 |
| Weighted-average interest rate | 0.3% | 0.3% | - | 0.5% | - | - | - | 0.3% |
| Securities | - | 21,989 | 133,613 | 106,896 | 188,064 | 200,035 | - | 650,597 |
| Weighted-average interest rate | - | 3.3% | 1.4% | 1.8% | 2.5% | 5.5% | - | 3.1% |
| Loans | - | 1,508,935 | 341,894 | 684,587 | 1,888,625 | 965,746 | 50,960 | 5,440,747 |
| Weighted-average interest rate | - | 5.5% | 7.5% | 6.6% | 6.2% | 6.1% | - | 6.0% |
| Other assets | - | - | - | - | - | - | 339,396 | 339,396 |
| Weighted-average interest rate | - | - | - | - | - | - | - | - |
| Total | \$ 68,941 | \$ 2,346,017 | \$ 475,507 | \$ 837,583 | \$ 2,076,689 | \$ 1,165,781 | \$ 390,356 | \$ 7,360,874 |
| Weighted-average interest rate | 0.3% | 3.7% | 5.8% | 5.6% | 5.8% | 6.0% | - | 4.8% |
| Liabilities and shareholders' equity | | | | | | | | |
| Deposits payable on demand | \$ 6 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 38,217 | \$ 38,223 |
| Weighted-average interest rate | - | - | - | - | - | - | - | - |
| Deposits payable on a fixed date | - | 568,242 | 632,830 | 2,132,314 | 2,240,214 | 786,090 | 11,909 | 6,371,599 |
| Weighted-average interest rate | - | 3.0% | 2.7% | 2.3% | 3.4% | 3.8% | - | 3.0% |
| Other liabilities | - | - | - | - | - | - | 360,764 | 360,764 |
| Weighted-average interest rate | - | - | - | - | - | - | - | - |
| Shareholders' equity | - | - | - | - | - | - | 590,288 | 590,288 |
| Weighted-average interest rate | - | - | - | - | - | - | - | - |
| Total | \$ 6 | \$ 568,242 | \$ 632,830 | \$ 2,132,314 | \$ 2,240,214 | \$ 786,090 | \$ 1,001,178 | \$ 7,360,874 |
| Weighted-average interest rate | - | 3.0% | 2.7% | 2.3% | 3.4% | 3.8% | - | 2.6% |
| | \$ 68,935 | \$ 1,777,775 | \$ (157,323) | \$ (1,294,731) | \$ (163,525) | \$ 379,691 | \$ (610,822) | \$ - |
| Credit commitments and derivatives | - | (307,364) | 70,977 | 29,137 | 207,266 | (16) | - | - |
| Weighted-average interest rate | - | (0.9%) | 6.6% | 5.2% | 3.6% | 9.8% | - | - |
| Interest rate sensitivity gap | \$ 68,935 | \$ 1,470,411 | \$ (86,346) | \$ (1,265,594) | \$ 43,741 | \$ 379,675 | \$ (610,822) | \$ - |
| Cumulative gap | \$ 68,935 | \$ 1,539,346 | \$ 1,453,000 | \$ 187,406 | \$ 231,147 | \$ 610,822 | \$ - | \$ - |

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NOTE 17 FAIR VALUE OF FINANCIAL INSTRUMENTS

The amounts set out in the following table represent the fair values of the Company's financial instruments, both on- and off-balance sheet, the valuation methods and assumptions of which are described below.

The estimated fair value amounts are designed to approximate amounts at which financial instruments could be exchanged in a current transaction between willing parties who are under no compulsion to act. For financial instruments which lack an available trading market, the Company applies present value and valuation techniques that use observable or unobservable market inputs. Because of the estimation process and the need to use judgement, the aggregate fair value amounts should not be interpreted as being necessarily realizable in an immediate settlement of the instruments.

| (000s) | | | 2010 | | 2009 | |
|--|----------------|------------|--------------------------------|----------------|------------|--------------------------------|
| | Carrying Value | Fair Value | Fair Value over Carrying Value | Carrying Value | Fair Value | Fair Value over Carrying Value |
| Assets | | | | | | |
| Cash resources | \$ 846,824 | \$ 846,824 | \$ - | \$ 930,134 | \$ 930,134 | \$ - |
| Securities | 543,892 | 543,892 | - | 650,597 | 650,597 | - |
| Loans | 5,832,569 | 6,080,034 | 247,465 | 5,440,747 | 5,775,417 | 334,670 |
| Securitization receivable | 343,402 | 343,402 | - | 229,418 | 229,418 | - |
| Other | 145,552 | 145,552 | - | 109,978 | 109,978 | - |
| Liabilities | | | | | | |
| Deposits and borrowings | 6,522,850 | 6,691,863 | 169,013 | 6,409,822 | 6,613,327 | 203,505 |
| Derivatives | 5,162 | 5,162 | - | 8,220 | 8,220 | - |
| Other | 441,947 | 441,947 | - | 352,544 | 352,544 | - |
| Off-balance sheet financial instruments | | | | | | |
| Credit commitments | \$ 540,363 | \$ 466,054 | \$ (74,309) | \$ 609,224 | \$ 629,318 | \$ 20,094 |

The following methods and assumptions were used to estimate the fair values of both on- and off-balance sheet financial instruments:

- > Cash resources are assumed to approximate their carrying values due to their short-term nature. The fair value of treasury bills is determined using rates from the Bank of Canada.
- > Securities are valued based on the quoted bid price as provided in Note 3.
- > Fair value of loans is determined by discounting the expected future cash flows of the loans at market rates for loans with similar terms and credit risks.
- > Securitization receivable is carried at fair value as described in Notes 1 and 5.
- > Other assets are assumed to approximate their carrying values due to their short-term nature.
- > Fair value of deposits payable on demand approximates their carrying value; fixed-rate deposits are determined by discounting the contractual cash flows using the market interest rates currently offered for deposits with similar terms and risks.
- > Other liabilities are assumed to approximate their carrying values due to their short-term nature.
- > Fair value of credit commitments is determined by discounting the expected future cash flows of the credit commitments at market rates for loans with similar terms and credit risks. Carrying value amount represents the notional amount of the commitments. Fair value amount represents the original notional amount adjusted for changes in fair value.
- > Fair value of derivative financial instruments is calculated as described in Note 15.

The Company uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

Level 1: Quoted (Unadjusted) Prices in Active Markets for Identical Assets or Liabilities: This level of hierarchy includes equity securities traded on the TSX and quoted corporate debt instruments.

Level 2: Valuation Techniques with Observable Parameters: This level of hierarchy includes interest rate swaps and bond forwards and certain corporate debt instruments.

Level 3: Valuation Techniques with Significant Unobservable Parameters: Instruments classified in this category have a parameter input or inputs which are unobservable and which have more than insignificant impact on either the fair value of the instrument or profit or loss of the instrument. This category includes the securitization receivable and interest rate swaps (seller swaps) used for hedging in the CMB program. Please see Notes 5 and 15 for further information on the securitization receivable and interest rate swaps.

The following table presents the carrying value of financial instruments held at fair value across all three levels of the fair value hierarchy.

| | 2010 | | | |
|---|-------------------|-------------------|-------------------|-------------------|
| (000s) | Level 1 | Level 2 | Level 3 | Total |
| Financial assets held for trading | | | | |
| Interest rate swaps (hedge swaps) | \$ - | \$ 17,381 | \$ - | \$ 17,381 |
| Financial instruments available for sale | | | | |
| Securities issued or guaranteed by | | | | |
| Canada | 5,080 | 119,625 | - | 124,705 |
| Corporations | 96,652 | - | - | 96,652 |
| Equity securities | | | | |
| Common | 7,362 | - | - | 7,362 |
| Fixed rate preferred | 309,331 | - | - | 309,331 |
| Income trusts | 4,727 | - | - | 4,727 |
| Mutual funds | - | 1,115 | - | 1,115 |
| Securitization receivable | - | - | 343,402 | 343,402 |
| Total | \$ 423,152 | \$ 138,121 | \$ 343,402 | \$ 904,675 |
| Financial liabilities at fair value | | | | |
| Interest rate swaps (seller swaps) | \$ - | \$ - | \$ 19,797 | \$ 19,797 |
| Interest rate swaps | - | 2,017 | - | 2,017 |
| Bond forward contracts | - | 729 | - | 729 |
| Total | \$ - | \$ 2,746 | \$ 19,797 | \$ 22,543 |
| | | | | 2009 |
| (000s) | Level 1 | Level 2 | Level 3 | Total |
| Financial assets held for trading | | | | |
| Bond forward contracts | \$ - | \$ 2,437 | \$ - | \$ 2,437 |
| Securities issued or guaranteed by Canada | 99,938 | - | - | 99,938 |
| Financial instruments available for sale | | | | |
| Securities issued or guaranteed by | | | | |
| Canada | - | 56,173 | - | 56,173 |
| Corporations | 194,085 | - | - | 194,085 |
| Equity securities | | | | |
| Common | 6,689 | - | - | 6,689 |
| Fixed rate preferred | 287,967 | - | - | 287,967 |
| Income trusts | 4,800 | - | - | 4,800 |
| Mutual funds | - | 945 | - | 945 |
| Securitization receivable | - | - | 229,418 | 229,418 |
| Total | \$ 593,479 | \$ 59,555 | \$ 229,418 | \$ 882,452 |
| Financial liabilities at fair value | | | | |
| Interest rate swaps | \$ - | \$ 350 | \$ 10,307 | \$ 10,657 |

The Company did not transfer any financial instrument from level 1 or level 2 to level 3 of the fair value hierarchy during 2010 or 2009.

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

NOTE 18 EARNINGS BY BUSINESS SEGMENT

The Company operates principally through two segments - mortgage lending and consumer lending. The mortgage lending operation consists of mortgage lending, securitization of government-insured mortgages and secured loans. The consumer lending operation consists of credit cards, PSiGate and individual loans to customers of retail businesses. These operating segments are supported by other activities including treasury and security investments and general corporate activities.

The following tables detail the earnings of the Company by business segment:

| | 2010 | | | |
|-----------------------------------|---------------------|-------------------|---------------------|---------------------|
| (000s) | Mortgage Lending | Consumer Lending | Other | Total |
| Net interest income | \$ 130,691 | \$ 35,761 | \$ 27,410 | \$ 193,862 |
| Provision for credit losses | (5,284) | (4,127) | - | (9,411) |
| Fees and other income | 15,243 | 15,229 | 218 | 30,690 |
| Securitization income | 107,724 | - | - | 107,724 |
| Net gain on securities and others | 421 | 3,917 | 8,953 | 13,291 |
| Non-interest expenses | (59,577) | (14,945) | (19,417) | (93,939) |
| Income before income taxes | 189,218 | 35,835 | 17,164 | 242,217 |
| Income taxes | (50,377) | (11,129) | 233 | (61,273) |
| Net income | \$ 138,841 | \$ 24,706 | \$ 17,397 | \$ 180,944 |
| Goodwill | \$ 2,324 | \$ 13,428 | \$ - | \$ 15,752 |
| Total assets | \$ 5,990,623 | \$ 514,872 | \$ 1,206,744 | \$ 7,712,239 |

2009

| (000s) | Mortgage Lending | Consumer Lending | Other | Total |
|-----------------------------------|---------------------|-------------------|---------------------|---------------------|
| Net interest income | \$ 100,268 | \$ 36,738 | \$ 28,005 | \$ 165,011 |
| Provision for credit losses | (9,653) | (1,873) | - | (11,526) |
| Fees and other income | 18,145 | 11,043 | 138 | 29,326 |
| Securitization income | 92,397 | - | - | 92,397 |
| Net gain on securities and others | 255 | - | 2,097 | 2,352 |
| Non-interest expenses | (48,482) | (10,862) | (19,257) | (78,601) |
| Income before income taxes | 152,930 | 35,046 | 10,983 | 198,959 |
| Income taxes | (41,279) | (11,631) | (1,556) | (54,466) |
| Net income | \$ 111,651 | \$ 23,415 | \$ 9,427 | \$ 144,493 |
| Goodwill | \$ 2,324 | \$ 13,428 | \$ - | \$ 15,752 |
| Total assets | \$ 5,510,368 | \$ 384,528 | \$ 1,465,978 | \$ 7,360,874 |

NOTE 19 RISK MANAGEMENT

The Company is exposed to various types of risk owing to the nature of the business activities it carries on. Types of risk to which the Company is subject include credit, liquidity, interest rate and other price risks. The Company has adopted enterprise risk management (ERM) as a discipline for managing risk. The Company's ERM structure is supported by a governance framework which includes policies, management standards, guidelines and procedures appropriate to each business activity. The policies are reviewed and approved annually by the Board of Directors.

A description of the Company's risk management policies and procedures is included in the shaded text of the Risk Management Section of the MD&A. Significant exposures to credit, liquidity and interest rate risks are described in Notes 3, 4, 15 and 16.

NOTE 20 COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform to the current year's presentation.