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# CANADIAN TIRE BANK

BASEL III PILLAR 3 DISCLOSURES

As at December 31, 2021

(unaudited)

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# CANADIAN TIRE BANK

## BASEL III PILLAR 3 DISCLOSURES

As at December 31, 2021

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### TABLE OF CONTENTS

1.	SCOPE OF APPLICATION	3
2.	CAPITAL STRUCTURE	5
3.	CAPITAL ADEQUACY	6
4.	CREDIT RISK: GENERAL DISCLOSURES	7
5.	CREDIT RISK: DISCLOSURES FOR PORTFOLIOS SUBJECT TO THE STANDARDIZED APPROACH	10
6.	CREDIT RISK: DISCLOSURES FOR PORTFOLIOS SUBJECT TO THE INTERNAL RATINGS-BASED APPROACH	10
7.	CREDIT RISK MITIGATION	10
8.	COUNTERPARTY CREDIT RISK	11
9.	SECURITIZATION	12
10.	MARKET RISK: STANDARDIZED APPROACH	14
11.	MARKET RISK: INTERNAL MODELS APPROACH	14
12.	OPERATIONAL RISK	14
13.	EQUITIES	15
14.	INTEREST RATE RISK	15
15.	LIQUIDITY AND FUNDING RISK	16
16.	LEVERAGE RATIO	17
17.	REMUNERATION	18

**CANADIAN TIRE BANK**  
**BASEL III PILLAR 3 DISCLOSURES**  
As at December 31, 2021

---

**1. SCOPE OF APPLICATION**

***Basis of preparation***

This document represents the Basel III Pillar 3 disclosures for Canadian Tire Bank (“the Bank”). The Basel III Pillar 3 disclosures included herein are made solely to meet the Office of the Superintendent of Financial Institutions Canada (“OSFI”) November 2007 requirements regarding the Basel Committee on Banking Supervisions update on “Basel II: International Convergence of Capital Measurement and Capital Standards: A Revised Framework – Comprehensive Version,” and “Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems.” The amounts disclosed in the tables below are the balance sheet carrying amounts included in the consolidated financial statements of the Bank prepared in accordance with International Financial Reporting Standards (“IFRS”) and using the accounting policies described therein.

The Basel III capital adequacy framework prescribed by OSFI is applied to the consolidated operations of the Bank, which include the Bank and a structured entity, Glacier Credit Card Trust (“GCCT”). The Bank is a wholly owned subsidiary of CTFS Holdings Limited (“CTFS Holdings”), itself a subsidiary of Canadian Tire Services Limited, formerly Canadian Tire Financial Services Limited, (“CTS”) which owns eighty percent of the common shares of CTFS Holdings. CTS is a wholly owned subsidiary of Canadian Tire Corporation, Limited (“CTC”). The Bank is not considered a Domestic Systemically Important Bank by OSFI.

The Bank is a federally regulated Schedule I bank that is the marketer and issuer of Triangle branded consumer credit cards including the Triangle Mastercard and Triangle World Elite Mastercard. CTB’s close integration with CTC’s retail banners and Dealers provides an advantage in acquiring new accounts and meeting the needs of CTC’s most loyal customers.

As a deposit taking institution, CTB also offers and markets high-interest savings accounts and guaranteed investment certificates (“GICs”), both within and outside tax-free savings accounts, and offers GICs through third party brokers.

This report is unaudited and is reported in thousands of Canadian Dollars, unless otherwise disclosed.

**CANADIAN TIRE BANK**  
**BASEL III PILLAR 3 DISCLOSURES**  
**As at December 31, 2021**

---

***Risk Management Framework***

The Board of Directors has oversight responsibility for the Bank's risk management framework, which specifically includes:

- Responsibility for oversight of the Bank's financial statements, financial reporting processes and the quality of its financial reporting including the accounting principles, significant judgments and disclosures;
- Responsibility for oversight of the risk management functions of the Bank with the assistance of and reporting by the Chief Risk Officer; and
- Responsibility for approving appropriate and prudent risk management policies (including tolerance limits) to mitigate business risks. This includes but is not limited to approving the Bank's Risk Appetite Framework.

Management has established the below committees in order to identify and monitor existing and emerging risks faced by the Bank, set out the appropriate controls and risk limits, and establish processes for monitoring adherence to these limits.

- Asset Liability Management Committee ("ALCO")
  - Provides oversight to ensure the Bank's balance sheet risks (including liquidity and funding, capital, interest rate risk, foreign exchange and securities and derivatives) are managed within established risk tolerance limits; and
  - Monitors financial market conditions and regulatory changes impacting balance sheet risks.
- Cross – Functional Risk Committee ("CRC")
  - Oversees the management of the Bank's key risks including identification, assessment and monitoring of risks and promotes an integrated and effective risk management culture; and
  - Reviews regular risk management reports describing outstanding risks issues and risk mitigation activities.

**CANADIAN TIRE BANK**  
**BASEL III PILLAR 3 DISCLOSURES**  
As at December 31, 2021

**2. CAPITAL STRUCTURE**

OSFI's regulatory capital guidelines under Basel III allow for two tiers of capital. Common Equity Tier 1 ("CET1") capital includes common shares, retained earnings and accumulated other comprehensive income, less regulatory adjustments which are deducted from capital. The Bank currently does not hold any additional Tier 1 capital instruments, therefore, the Bank's CET1 is equal to its Tier 1 regulatory capital. Tier 2 capital consists of the eligible portion of general allowances.

		2021	2020
<b>Common Equity Tier 1 Capital: Instruments and Reserves</b>			
1	Directly issued qualifying common share capital (and equivalent for non-joint stock companies) plus related stock surplus	\$ 431,631	\$ 431,631
2	Retained Earnings	722,116	579,766
3	Accumulated other comprehensive income (and other reserves)	(47,333)	(68,245)
6	<b>Common Equity Tier 1 capital before regulatory adjustments</b>	<b>1,106,414</b>	<b>943,152</b>
<b>Common Equity Tier 1 capital: regulatory adjustments</b>			
28	Total regulatory adjustments to Common Equity Tier 1	25,559	(5,014)
29	<b>Common Equity Tier 1 capital (CET1)</b>	<b>\$ 1,131,973</b>	<b>\$ 938,137</b>
<b>Additional Tier 1 capital: instruments</b>			
36	<b>Additional Tier 1 capital before regulatory adjustments</b>	-	-
<b>Additional Tier 1 capital: regulatory adjustments</b>			
43	<b>Total regulatory adjustments to Additional Tier 1 capital</b>	-	-
44	<b>Additional Tier 1 capital (AT1)</b>	-	-
45	<b>Tier 1 capital (T1 = CET1 + AT1)</b>	<b>\$ 1,131,973</b>	<b>\$ 938,137</b>
<b>Tier 2 Capital: Instruments and Provisions and Regulatory Adjustments</b>			
51	<b>Tier 2 capital before regulatory adjustments</b>	<b>52,640</b>	<b>39,509</b>
<b>Tier 2 capital: regulatory adjustments</b>			
57	Total regulatory adjustments to Tier 2 capital	-	-
58	<b>Tier 2 capital (T2)</b>	<b>52,640</b>	<b>39,509</b>
59	<b>Total capital (TC = T1 + T2)</b>	<b>\$ 1,184,613</b>	<b>\$ 977,646</b>
60	<b>Total risk-weighted assets</b>	<b>\$ 6,378,132</b>	<b>\$ 5,338,741</b>
<b>Capital ratios</b>			
61	Common Equity Tier 1 (as percentage of risk-weighted assets)	17.7%	17.6%
62	Tier 1 (as percentage of risk-weighted assets)	17.7%	17.6%
63	Total capital (as percentage of risk-weighted assets)	18.6%	18.3%
<b>OSFI target</b>			
69	Common Equity Tier 1 capital target ratio	7.0%	7.0%
70	Tier 1 capital target ratio	8.5%	8.5%
71	Total capital target ratio	10.5%	10.5%

**CANADIAN TIRE BANK**  
**BASEL III PILLAR 3 DISCLOSURES**  
As at December 31, 2021

---

### **3. CAPITAL ADEQUACY**

The Bank manages its capital under guidelines established by OSFI and uses both internal and regulatory minimum capital ratio targets to monitor its capital base. OSFI's capital and leverage guidelines measure capital in relation to credit, market and operational risks and provide an overall measure of the adequacy of an institution's capital. The Bank has various capital policies, procedures and controls in place, including an annual Internal Capital Adequacy Assessment Process ("ICAAP"), which it utilizes to achieve its goals and objectives. The ICAAP is reviewed and approved by the Board of Directors. The Bank's objectives include:

- Providing sufficient capital to maintain the confidence of investors and depositors; and
- Being an appropriately capitalized institution, as measured internally, defined by regulatory authorities.

#### ***Capital and leverage ratios***

The capital and leverage ratios are prescribed in OSFI's Capital Adequacy Requirements and Leverage Requirements Guidelines. The capital ratios are calculated as regulatory capital divided by risk-weighted assets ("RWA"). The leverage ratio is calculated as Tier 1 capital divided by the leverage ratio exposure.

RWA includes a credit risk component for all on- and off-balance sheet assets and financial instruments, an operational risk component based on a percentage of average risk-weighted revenues, and a market risk component for assets held for trade. For the purpose of calculating RWA, securitization transactions are considered off-balance sheet transactions and therefore securitized assets are not included in the RWA calculation.

The Bank uses the standardized approach for credit risk for all on- and off-balance sheet exposures, the basic indicator approach for all components of operational risk, and the standardized approach for market risk. The Bank is not required to hold any capital in relation to market risk as the Bank does not have assets classified as held for trade.

The leverage ratio exposure is the sum of on-balance sheet exposures, derivatives exposures, securities financing transactions exposures, and subordinate loans, with a reduction for off-balance sheet items, which include securitized assets. The components of the leverage ratio exposure are presented in Note 16.

As at December 31, 2021 and 2020, the Bank complied with all regulatory capital guidelines established by OSFI and its internal targets as determined by its ICAAP.

**CANADIAN TIRE BANK**  
BASEL III PILLAR 3 DISCLOSURES  
As at December 31, 2021

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#### **4. CREDIT RISK: GENERAL DISCLOSURES**

Credit risk is the risk of financial loss resulting from the failure of a debtor, for any reason, to fully honour its financial contractual obligations to the Bank. This is the most significant financial risk exposure faced by the Bank and arises principally from the Bank's loans receivable.

##### ***Objectives, policies and processes***

The objective of the Bank's credit risk management program is to manage its risk within an appropriate tolerance and to maximize the overall return on the risks taken.

The Bank's Credit Risk Management Policy establishes how the Bank manages credit risks incurred through its business activities. The Board of Directors have overall responsibility for the Credit Risk Management Policy by ensuring that management has a framework and policies, processes and procedures in place to manage credit risks and that the overall credit risk policies are complied with at the business transaction level. The Bank's Credit Risk Management Policy is comprised of the following categories:

- Approval Authorities
- Risk Tolerance Limits
- Credit Risk Identification
- Credit Granting and Collection
- Impaired Loans, Allowance and Write-offs

##### ***Concentrations of credit risk***

Concentrations of credit risk exist if a number of customers are engaged in similar activities, are located in the same geographic region or have similar economic characteristics such that their ability to meet contractual obligations could be similarly affected by changes in economic, political or other conditions. Concentrations of credit risk indicate a related sensitivity of the Bank's performance to developments affecting a particular counterparty, industry or geographic location. The Bank uses sophisticated credit scoring models, monitoring technology and collection modeling techniques to implement and manage strategies, policies and limits that are designed to control risk. Loans receivable are generated by a large and geographically dispersed group of customers primarily within Canada. Current credit exposure is limited to the loss that would be incurred if all of the Bank's counterparties were to default at the same time.

##### ***Risk measurement***

The Bank maintains comprehensive procedures and information systems to effectively monitor and control the characteristics and quality of its credit portfolio. To ensure the Bank's credit granting, documentation and collection processes are followed correctly, the Bank maintains the following:

- A credit rating system that defines risk-rating criteria and rates all credits individually according to those criteria
- Portfolio characteristic monitoring
- Credit review processes
- Independent inspections of its credit portfolio to ensure compliance

**CANADIAN TIRE BANK**  
**BASEL III PILLAR 3 DISCLOSURES**  
As at December 31, 2021

**Credit risk by exposure type**

	2021	2020
Investment securities		
Government debt securities	\$ 794,065	\$ 1,004,463
Bank and corporate debt securities	961,776	715,827
Loans receivable <sup>1</sup>	5,549,157	4,983,837
<b>Total</b>	<b>\$ 7,304,998</b>	<b>\$ 6,704,128</b>

<sup>1</sup> Net loans receivable including securitized loans

**Credit risk by contractual maturity**

	As at December 31, 2021					Total
	Less than 3 months	3 months to 1 year	1 to 3 years	3 to 5 years	>5 years	
Investment securities						
Government debt securities	\$ 252,054	\$ 366,901	\$ 175,110	\$ -	\$ -	\$ 794,065
Bank and corporate debt securities	961,776	-	-	-	-	961,776
Loans receivable <sup>1</sup>	5,549,157	-	-	-	-	5,549,157
<b>Total</b>	<b>\$ 6,762,987</b>	<b>\$ 366,901</b>	<b>\$ 175,110</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 7,304,998</b>

<sup>1</sup> Net loans receivable including securitized loans

**Allowance for credit losses**

Expected Credit Losses (“ECL”) are calculated as the product of the probability of default, exposure at default, and loss given default over the remaining expected life of the financial instrument and discounted to the reporting date. The ECL model also incorporates forward-looking information, which increases the degree of judgment required as to how changes in macro-economic factors will affect ECLs. Macro-economic factors taken into consideration include, but are not limited to, unemployment rate, and require an evaluation of both the current and forecast direction of the macro-economic cycle. The methodologies and assumptions, including any forecasts of future economic conditions, are reviewed regularly.

The ECL approach measures the loss allowance using a three-stage approach based on the extent of credit deterioration since origination:

- Stage 1 – Where there has not been a significant increase in credit risk since initial recognition of a financial instrument, an amount equal to 12-month ECL is recorded, which represents the portion of lifetime ECL that is expected to result from default events that are possible within 12 months after the reporting date.
- Stage 2 – Financial instruments that have experienced a significant increase in credit risk subsequent to origination but are not in default, an amount equal to lifetime ECL is recorded. Lifetime ECL represents the expected losses that will result from all probable default events over the expected life of a financial instrument.
- Stage 3 – Financial instruments that are considered to be in default (credit impaired) are included in this stage. Similar to Stage 2, the allowance is recognized at lifetime ECL.

A significant increase in credit risk is assessed based on changes in the probability of default since initial recognition along with borrower-specific qualitative information, or when the loan is 30 days past due. Credit card loans are considered impaired and in default when they are contractually 90 days past due or there is sufficient doubt about the ultimate collectability of principal and/or interest.



**CANADIAN TIRE BANK**  
**BASEL III PILLAR 3 DISCLOSURES**  
**As at December 31, 2021**

The Bank recognizes a loss allowance on a forward-looking basis at an amount equal to the lifetime ECL on its financial assets measured at amortized cost, except for the following, which are measured at 12-month ECL:

- Debt investments that are determined to have low credit risk at the reporting date with a credit risk rating equivalent to investment grade; and
- Other financial assets, such as loan receivables, for which credit risk has not increased significantly since initial recognition.

All loans receivable are assessed for impairment. All loans receivable found not to be specifically impaired are then collectively assessed for impairment. Loans receivables are collectively assessed for impairment by grouping together loans receivable with similar risk characteristics.

***Allowance for credit losses***

	12 month ECL (Stage 1)	Lifetime ECL not credit-impaired (Stage 2)	Lifetime ECL credit-impaired (Stage 3)	Total
Allowance for credit losses, beginning of year	\$ 409,147	\$ 161,333	\$ 293,534	\$ 864,014
Write Offs	(7,745)	(15,944)	(313,970)	(337,659)
Recoveries	-	-	91,296	91,296
New loans originated	25,482	-	-	25,482
Transfers				
to Stage 1	114,836	(37,996)	(76,840)	-
to Stage 2	(15,446)	23,714	(8,268)	-
to Stage 3	(21,002)	(19,836)	40,838	-
Net re-measurement	(69,379)	62,985	204,725	198,331
<b>Allowance for credit losses, end of year</b>	<b>\$ 435,893</b>	<b>\$ 174,256</b>	<b>\$ 231,315</b>	<b>\$ 841,464</b>

The Bank continues to seek recovery on amounts that were written-off during the year. The Bank pursues recovery unless it no longer has the right to collect, the receivable has been sold to a third party, or all reasonable efforts to collect have been exhausted.

The following table sets out information about the credit risk exposure of loans receivables at December 31, 2021:

	(Stage 1)	(Stage 2)	(Stage 3)	Total
Low risk	\$ 2,830,279	\$ 57,403	\$ -	\$ 2,887,682
Moderate risk	1,961,823	100,531	-	2,062,354
High risk	779,071	169,998	491,516	1,440,585
Total gross carrying amount	5,571,173	327,932	491,516	6,390,621
ECL allowance	435,893	174,256	231,315	841,464
<b>Net carrying amount</b>	<b>\$ 5,135,280</b>	<b>\$ 153,676</b>	<b>\$ 260,201</b>	<b>\$ 5,549,157</b>

**CANADIAN TIRE BANK**  
**BASEL III PILLAR 3 DISCLOSURES**  
As at December 31, 2021

**Past due loans**

A loan is considered past due when a customer has not made the indicated payment by the contractual due date. The following table presents the carrying value of loans that are past due. Credit card loans are written down to their net realizable value when a payment is 180 days in arrears or when likelihood of collection is remote. No collateral is held against loans receivable.

	As at December 31, 2021			
	1-30 days	31-90 days	> 90 days	Total
Loans receivable	\$ 169,469	\$ 70,749	\$ 55,245	\$ 295,463

**5. CREDIT RISK: DISCLOSURES FOR PORTFOLIOS SUBJECT TO THE STANDARDIZED APPROACH**

Credit ratings for investment securities are obtained from three rating agencies - DBRS Morningstar, S&P Global and Moody's Investors Service. Investment securities consist of government debt securities and bank and corporate debt securities. Investment securities have risk-weightings from 0% to 100% based on their credit rating. Derivative instruments consist of foreign exchange and interest rate derivatives and are risk weighted from 20% to 100% according to their counterparty.

**Risk-weighted assets by exposure type**

	Risk	2021		2020	
	Weighting	2021	2020	2021	2020
Government debt securities	0%	\$ -	\$ -	-	-
Bank and corporate debt securities	20%	192,355	-	140,666	-
Derivative instruments	20% - 100%	38,232	-	15,099	-

**6. CREDIT RISK: DISCLOSURES FOR PORTFOLIOS SUBJECT TO THE INTERNAL RATINGS-BASED APPROACH**

The Bank does not have any portfolios subject to the Internal Ratings-Based Approach.

**7. CREDIT RISK MITIGATION**

Loans receivable consist of credit card and other loans receivable. The loans are unsecured and are not guaranteed. Investment securities are subject to the policies, procedures and controls as described in Note 8.

**CANADIAN TIRE BANK**  
BASEL III PILLAR 3 DISCLOSURES  
As at December 31, 2021

---

**8. COUNTERPARTY CREDIT RISK**

Counterparty credit risk is the risk that the counterparty to a transaction may default prior to the final settlement of the cash flows pertaining to that transaction. This may relate to financial derivatives, securities financing transactions and long settlement transactions.

The Bank's Credit Risk Management and Securities and Derivatives Policies establish how the Bank manages counterparty credit risks incurred through its business activities. The Board of Directors has overall responsibility for the Credit Risk Management and Securities and Derivatives Policies by ensuring that management has a framework and policies, processes and procedures in place to manage counterparty credit risks and that the overall counterparty credit risk policies are complied with at the business transaction level. The Bank is committed to ensuring the preservation of capital and maintaining adequate liquidity to meet cash flow requirements. The Bank does not invest or enter into derivative transactions for speculative purposes. Counterparty credit risk will be minimized by:

- Setting minimum acceptable credit ratings for investments;
- Setting maximum group limits for related issuers;
- Limiting investments to higher credit quality fixed income securities with a maximum maturity of five years; and
- Diversifying the portfolio so that potential losses on individual securities are minimized.

***Counterparty credit risk exposure***

	2021	2020
Government debt securities	\$ 794,065	\$ 1,004,463
Bank and corporate debt securities	\$ 961,776	\$ 715,827
Derivative instruments	\$ 53,816	\$ 14,546

**CANADIAN TIRE BANK**  
**BASEL III PILLAR 3 DISCLOSURES**  
As at December 31, 2021

**9. SECURITIZATION**

The Bank acts as originator and liquidity provider to its own securitizations. The Bank uses securitization to diversify funding sources and for capital efficiency purposes. The Bank will also from time-to-time invest in third party high quality short term asset-backed commercial paper investment securities.

The consolidated financial statements include the financial statements of the Bank and GCCT as explained below. Strictly for the purpose of calculating RWA, securitization transactions are considered off-balance sheet transactions and therefore securitization assets are not included in the RWA calculation. The Bank uses the standardized approach for securitization exposures.

GCCT is a structured entity that was created to securitize the Bank's credit card loans receivable. The Bank has transferred co-ownership interest in credit card loans receivable to GCCT and has determined, for the purposes of accounting, consolidation of GCCT is appropriate. The associated liabilities secured by these assets, include the commercial paper notes and term notes on the consolidated statement of financial position and are carried at amortized cost. The table below sets out the carrying amounts and fair values of the Bank's transferred credit card loan receivables and associated liabilities.

	2021		2020	
	Carrying value	Fair value	Carrying value	Fair value
Credit card loans receivable transferred	\$ 2,234,062	\$ 2,234,062	\$ 2,280,022	\$ 2,280,022
Associated liabilities	2,229,734	2,256,516	2,291,865	2,378,972
Net position	\$ 4,328	\$ (22,454)	\$ (11,843)	\$ (98,950)

For legal purposes, the co-ownership interests in the Bank's receivables that are owned by GCCT have been sold at law to GCCT and are not available to the creditors of the Bank.

The Bank has not identified any factors arising from current market circumstances that could lead to a need for the Bank to extend liquidity and/or credit support to GCCT over and above the existing arrangements or that could otherwise change the substance of the Bank's relationship with GCCT. There have been no changes in the capital structure of GCCT since the Bank's assessment for consolidation.

***Commercial paper notes***

The asset-backed commercial paper notes are short-term notes issued by GCCT as financing for the 1997-1 series securitization deal. These commercial paper notes have varying original maturities of 364 days or less at interest rates fixed at the time of each renewal. The commercial paper notes may bear interest payable at maturity or be sold at a discount and mature at face value. Commercial paper notes issued by GCCT are recorded at amortized cost.

Series 1997-1 notes will be repaid either through the application of collections distributed to GCCT in respect of the series 1997-1 ownership interest or by issuing replacement notes and applying the proceeds to repay existing notes, or some combination of the two. The series 1997-1 notes will also be subject to early repayment if any of the events listed at the conclusion of this note (page 14) occur.

**CANADIAN TIRE BANK**  
**BASEL III PILLAR 3 DISCLOSURES**  
As at December 31, 2021

**Term notes**

Term notes are made up of senior notes and subordinated notes issued by GCCT with an original maturity of three to five years.

	Expected Repayment Date	Coupon Interest Rate	2021	2020
<b>Senior notes</b>				
Series 2017-1	September 20, 2022	2.048%	523,600	523,600
Series 2018-1	September 20, 2023	3.138%	546,000	546,000
Series 2019-1	June 6, 2024	2.280%	523,600	523,600
Series 2020-1	September 22, 2025	1.388%	448,800	448,800
Series 2020-B	October 12, 2024	Variable	1	1
			<b>2,042,001</b>	<b>2,042,001</b>
<b>Subordinated notes</b>				
Series 2017-1	September 20, 2022	3.298%	36,400	36,400
Series 2018-1	September 20, 2023	4.138%	37,958	37,958
Series 2019-1	June 6, 2024	3.430%	36,400	36,400
Series 2020-1	September 22, 2025	2.438%	31,200	31,200
			<b>141,958</b>	<b>141,958</b>
<b>Transaction costs</b>				
			<b>(4,360)</b>	<b>(6,405)</b>
			<b>\$ 2,179,599</b>	<b>\$ 2,177,554</b>

Asset-backed series senior and subordinated notes issued by GCCT are recorded at amortized cost. Transaction costs related to the issuance of the notes are netted against the carrying value of the notes and amortized over the expected life of the notes as part of the interest expense.

Subject to the payment of certain priority amounts, the series senior notes have recourse on a priority basis to the related series ownership interest. The series subordinated notes have recourse to the related series ownership interests on a subordinated basis to the series senior notes in terms of the priority of payment of principal and interest. The series notes, together with certain other permitted obligations of GCCT, are secured by the assets of GCCT. The entitlement of note holders and other parties to such assets is governed by the priority and payment provisions set forth in the Trust Indenture and the related series supplements under which these series of notes were issued, as well as the series purchase agreements which set forth the Bank's over collateralization.

Repayment of the principal of the series 2017-1, 2018-1, 2019-1, 2020-1 and 2020-B notes is scheduled to commence and be completed on the expected repayment dates indicated in the preceding table. Following repayment of principal owing, and in some circumstances interest, under the series senior notes, collections distributed to GCCT in respect of the related ownership interests will be applied to pay principal owing under series subordinated notes.

**CANADIAN TIRE BANK**  
**BASEL III PILLAR 3 DISCLOSURES**  
**As at December 31, 2021**

---

Principal repayments may commence earlier than the expected repayment date (an amortization period) if certain events occur, including:

- a) The Bank failing to make required distributions to GCCT, or failing to meet covenant or other contractual terms;
- b) The performance of the receivables failing to achieve set criteria; or
- c) Insufficient receivables in the pool.

None of these events have occurred for the years ending December 31, 2021 and 2020.

## **10. MARKET RISK: STANDARDIZED APPROACH**

Market risk is the risk of loss that may arise from changes in market factors such as interest rates and foreign exchange rates.

### *Objectives, policies and processes*

It is the Bank's objective to effectively and efficiently manage its consolidated statement of financial position in order to maximize shareholder value within risk limits established in the Asset Liability Management Policy. This policy dictates interest rate and foreign exchange risk limits.

The Bank's key risks include interest rate risk (discussed in Note 14) and foreign exchange risk. Interest rate contracts are used to hedge future securitization and deposit transactions that are expected to be completed within the next five years. Foreign exchange contracts are used to hedge contractual commitments in a foreign currency.

The Asset Liability Management Policy dictates the following foreign exchange risk limits in the Bank:

- Approved currencies are restricted to Canadian dollars and United States dollars.
- Approved transactions are restricted to spots, forwards and swaps.
- Maximum maturity of foreign exchange contracts is 18 months. The Bank's President can approve hedges greater than 18 months provided a contractual commitment in a foreign currency exists.
- The foreign exchange hedge limits are:
  - Hedge a minimum of 75% of the forecast foreign exchange requirements for the period one to six months forward.
  - Hedge a minimum of 25% and a maximum of 75% of the forecast foreign exchange requirements for the period seven to 12 months forward.
  - Hedge a maximum of 50% of the forecast foreign exchange requirements for the period 13 to 18 months forward.

The standardized approach is used for the market risk component for assets held for trade. Assets are classified as held for trade when they are held with trading intent. The Bank does not have assets classified as held for trade nor does it hold any derivative financial instruments for speculative purposes. Therefore the Bank is not required to hold any capital in relation to market risk.

The Bank is in compliance with its foreign exchange risk limits as at December 31, 2021 and 2020.

## **11. MARKET RISK: INTERNAL MODELS APPROACH**

The Bank does not use the internal models approach for trading portfolios.

## **12. OPERATIONAL RISK**

The Bank uses the basic indicator approach for operational risk. Operational risk is based on a percentage of average risk-weighted revenues.

**CANADIAN TIRE BANK**  
**BASEL III PILLAR 3 DISCLOSURES**  
As at December 31, 2021

**13. EQUITIES**

The Bank holds equity investments that are recorded at \$nil cost as the shares were awarded at no cost, are not quoted in an active market and their fair value cannot be reliably measured.

**14. INTEREST RATE RISK**

Interest rate risk reflects the Bank's financial sensitivity to movements in interest rates. Interest rate exposure may produce favourable or unfavourable effects depending on the nature of the exposure, and the direction and volatility of interest rate fluctuations. Interest rate exposure is affected by the interest rate sensitivity of assets and liabilities.

***Objectives, policies and processes***

It is the Bank's objective to effectively and efficiently manage its consolidated statement of financial position in order to maximize shareholder value within risk limits established in the Asset Liability Management Policy. This policy dictates interest rate risk limits.

The Asset Liability Management Policy dictates the following interest rate risk limits for the most adverse result from a plus or minus 100 bps and 200 bps parallel shift in interest rates in the Bank:

- Projected net interest income may decline by no more than 6% (2020 – 6%)
- Net economic value of equity ("EVE") may decline by no more than 12% (2020 – 12%)

EVE is defined as the present value of assets less the present value of liabilities.

The Bank mitigates its interest rate risks as it enters into hedging contracts in accordance with the guidelines in the Asset Liability Management Policy to hedge securitization and deposit issuances that are expected to be completed within the next five years.

The following table provides the projected impact of a 200 bps and 100 bps decrease or increase in interest rates.

	Limit	2021				2020			
		-200 bps	-100 bps	+100 bps	+200 bps	-200 bps	-100 bps	+100 bps	+200 bps
Net Interest Income	-6%	0.0%	-0.2%	0.3%	0.6%	0.3%	0.0%	1.4%	2.8%
Net Economic Value of Equity	-12%	-3.2%	-4.0%	3.0%	12.9%	-6.7%	-6.4%	7.1%	20.0%

**CANADIAN TIRE BANK**  
BASEL III PILLAR 3 DISCLOSURES  
As at December 31, 2021

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**15. LIQUIDITY AND FUNDING RISK**

Liquidity and funding risk is the risk that the Bank may be unable to generate or obtain sufficient cash or its equivalent in a timely and cost-effective manner to meet its commitments as they come due.

***Objectives, policies and processes***

It is the Bank's objective to ensure the availability of adequate funds by maintaining a strong liquidity management framework and to satisfy all applicable regulatory and statutory requirements. The Asset Liability Management Policy dictates liquidity and funding limits and requires the establishment of an annual Liquidity and Funding Plan which includes risk measurement methodologies, scenario analysis, stress testing and also provides roles, responsibilities and key actions in managing a liquidity crisis. Stress tests are conducted on a regular basis for a variety of bank-specific and market-wide stress scenarios to identify sources of potential strain, to measure the impact on funding requirements and to ensure that current exposures remain in accordance with the Bank's established liquidity and funding risk tolerance. Stress test scenarios include disruption to the securitization funding market, immediate terminations within broker deposits, unexpected and persistent withdrawals of retail deposits, and balance sheet growth greater than forecast.

The Asset Liability Management Policy dictates that the Bank must maintain a minimum liquidity coverage ratio of 110% (2020 – 110%). The liquidity coverage ratio measures the amount of liquid assets available to offset net cash outflows over a 30-day period that could occur under an acute short-term stress scenario.

The Bank's liquidity coverage ratio at December 31, 2021 was 1089% (2020 – 881%).

The Bank assesses the adequacy of its liquidity position by analyzing its current liquidity position, present and anticipated funding requirements, and alternative sources of funds. Future cash inflows and outflows as well as the above noted ratio are forecast daily.

The Bank maintains a variety of funding sources to reduce the concentration risk from any one source. The Bank's funding sources include cash from operations, securitization of credit card loans receivable, broker deposits, retail deposits, intercompany borrowings, and committed credit facilities.



**CANADIAN TIRE BANK**  
**BASEL III PILLAR 3 DISCLOSURES**  
As at December 31, 2021

**16. LEVERAGE RATIO**

The following summarizes the Bank's leverage ratio.

		2021	2020
<b>On-balance sheet exposures</b>			
1	On-balance sheet items (excluding derivatives, SFTs and grandfathered securitization exposures but including collateral)	\$ 5,361,682	\$ 7,035,271
2	(Asset amounts deducted in determining Basel III Tier 1 capital)	25,559	(5,014)
3	<b>Total on-balance sheet exposures</b> (excluding derivatives and SFTs) (sum of lines 1 and 2)	\$ 5,387,241	\$ 7,030,256
<b>Derivative exposures</b>			
4	Replacement cost associated with all derivative transactions (ie net of eligible cash variation margin)	\$ 74,867	\$ 15,625
5	Add-on amounts for PFE associated with all derivative transactions	72,834	54,741
6	Gross up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the operative accounting framework	-	-
7	(Deductions of receivables assets for cash variation margin provided in derivative transactions)	-	-
8	(Exempted CCP-leg of client cleared trade exposures)	-	-
9	Adjusted effective notional amount of written credit derivatives	-	-
10	(Adjusted effective notional offsets and add-on deductions for written credit derivatives)	-	-
11	<b>Total derivative exposures (sum of lines 4 to 10)</b>	\$ 147,701	\$ 70,366
<b>Securities financing transaction exposures</b>			
16	<b>Total securities financing transaction exposures (sum of lines 12 to 15)</b>	-	-
<b>Other off-balance sheet exposures</b>			
17	Off-balance sheet exposure at gross notional amount	\$ 10,690,181	\$ 9,752,151
18	(Adjustments for conversion to credit equivalent amounts)	(9,574,557)	(8,776,936)
19	<b>Off-balance sheet items (sum of lines 17 and 18)</b>	\$ 1,115,624	\$ 975,215
<b>Capital and Total Exposures</b>			
20	<b>Tier 1 capital</b>	\$ 1,131,973	\$ 938,137
21	<b>Total Exposures (sum of lines 3, 11, 16 and 19)</b>	\$ 6,650,566	\$ 8,075,837
<b>Leverage Ratios</b>			
22	<b>Basel III leverage ratio</b>	17.0%	11.6%

**CANADIAN TIRE BANK**  
BASEL III PILLAR 3 DISCLOSURES  
As at December 31, 2021

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**17. REMUNERATION**

The Bank follows the remuneration policies of its ultimate parent CTC. The Management Resources and Compensation committee of the CTC Board of Directors is responsible for the oversight of CTC's compensation structure for senior management including salaries, annual and long-term incentive plans and plans involving share issuances and share unit awards.

***Key management personnel compensation***

	2021	2020
Salaries and other short-term employee benefits	\$ 3,082	\$ 2,991
Other long-term benefits	231	201
Share-based payment transactions	2,717	579
Directors fees, expenses and share unit plan	632	517
	\$ 6,662	\$ 4,288

In addition to their salaries, the Bank's employees participate in the employee future benefit plan of CTC, which provides certain health care, dental care, life insurance and other benefits, but not pensions, to employees upon retirement. Employees also participate in stock-based compensation plans operated by CTC.

Senior management also participate in a short-term incentive plan ("STIP") and long-term incentive plan ("LTIP") operated by CTC.

The objective of the STIP is to motivate and reward senior managers for the achievement of annual operating and financial goals. Evaluation of individual performance is based on the achievement of established individual objectives that are aligned to key areas of strategic focus and are critical to the achievement of CTC's business strategy. In determining the payout under the STIP plan, performance is measured against both financial and non-financial measures to avoid inappropriate risks.

The objective of the LTIP is to align the interests of senior managers with the achievement of CTC's long-term business objectives as well as with the interests of shareholders.

Full details of CTC's compensation arrangements can be found in the Management Information Circular, available on the CTC Investor Relations website.