



Interim Consolidated Financial Statements
April 30, 2019
(Unaudited)

VERSABANK

Consolidated Balance Sheets (Unaudited)

(thousands of Canadian dollars)

As at	April 30 2019	October 31 2018	April 30 2018
Assets			
Cash	\$ 122,090	\$ 129,781	\$ 144,220
Securities	10,039	10,017	-
Loans, net of allowance for credit losses (note 4)	1,628,116	1,631,026	1,564,424
Other assets (note 5)	35,947	38,306	42,053
	<u>\$ 1,796,192</u>	<u>\$ 1,809,130</u>	<u>\$ 1,750,697</u>
Liabilities and Shareholders' Equity			
Deposits	\$ 1,425,057	\$ 1,437,431	\$ 1,393,916
Subordinated notes payable (note 6 and 13)	4,876	9,844	9,814
Securitization liabilities (note 7)	33,338	33,310	33,283
Other liabilities (note 8)	101,182	104,978	98,437
	<u>1,564,453</u>	<u>1,585,563</u>	<u>1,535,450</u>
Shareholders' equity:			
Share capital (note 9)	182,094	182,094	182,094
Retained earnings	49,645	41,473	33,153
	<u>231,739</u>	<u>223,567</u>	<u>215,247</u>
	<u>\$ 1,796,192</u>	<u>\$ 1,809,130</u>	<u>\$ 1,750,697</u>

The accompanying notes are an integral part of these interim Consolidated Financial Statements.

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Consolidated Statements of Comprehensive Income (Unaudited)

(thousands of Canadian dollars, except per share amounts)

	for the three months ended		for the six months ended	
	April 30	April 30	April 30	April 30
	2019	2018	2019	2018
Interest income:				
Loans	\$ 20,398	\$ 18,732	\$ 41,528	\$ 37,300
Cash and securities	727	631	1,556	1,132
	21,125	19,363	43,084	38,432
Interest expense:				
Deposits and other	8,099	6,721	16,401	13,180
Subordinated notes	283	210	500	425
	8,382	6,931	16,901	13,605
Net interest income	12,743	12,432	26,183	24,827
Non-interest income	4	37	23	49
Total revenue	12,747	12,469	26,206	24,876
Provision (recovery) for credit losses (note 4)	(411)	(50)	(700)	15
	13,158	12,519	26,906	24,861
Non-interest expenses:				
Salaries and benefits	3,859	3,439	7,764	6,907
General and administrative	1,938	2,576	4,340	5,493
Premises and equipment	614	602	1,261	1,107
	6,411	6,617	13,365	13,507
Income before income taxes	6,747	5,902	13,541	11,354
Income taxes (note 10)	1,851	1,646	3,713	3,122
Net income	\$ 4,896	\$ 4,256	\$ 9,828	\$ 8,232
Other comprehensive income (loss), net of income taxes				
Net unrealized gains (losses) on assets held as available-for-sale ⁽¹⁾	-	-	-	(4)
Comprehensive income	\$ 4,896	\$ 4,256	\$ 9,828	\$ 8,228
Basic and diluted income per common share (note 11)	\$ 0.21	\$ 0.18	\$ 0.41	\$ 0.34
Weighted average number of common shares outstanding	21,123,559	21,123,559	21,123,559	21,123,559

The accompanying notes are an integral part of these interim Consolidated Financial Statement

(1) Net of income tax expense for the three months of \$nil (2018 – \$nil) and income tax benefit for the six months of \$nil (2018 – \$2).

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Consolidated Statements of Changes in Shareholders' Equity (Unaudited)

(thousands of Canadian dollars)

	for the three months ended		for the six months ended	
	April 30	April 30	April 30	April 30
	2019	2018	2019	2018
Common shares (note 9):				
Balance, beginning and end of the period	\$ 152,612	\$ 152,612	\$ 152,612	\$ 152,612
Preferred shares (note 9):				
<i>Series 1 preferred shares</i>				
Balance, beginning and end of the period	\$ 13,647	\$ 13,647	\$ 13,647	\$ 13,647
<i>Series 3 preferred shares</i>				
Balance, beginning and end of the period	\$ 15,690	\$ 15,690	\$ 15,690	\$ 15,690
Contributed surplus:				
Balance, beginning and end of the period	\$ 145	\$ 145	\$ 145	\$ 145
Total share capital	\$ 182,094	\$ 182,094	\$ 182,094	\$ 182,094
Retained earnings:				
Balance, beginning of the period	\$ 45,616	\$ 29,658	\$ 41,473	\$ 26,443
Impact of adopting IFRS 9	-	-	78	-
Net income	4,896	4,256	9,828	8,232
Dividends paid on common and preferred shares	(867)	(761)	(1,734)	(1,522)
Balance, end of the period	\$ 49,645	\$ 33,153	\$ 49,645	\$ 33,153
Accumulated other comprehensive income, net of taxes:				
Balance, beginning of the period	\$ -	\$ -	\$ -	\$ 4
Other comprehensive income (loss)	-	-	-	(4)
Balance, end of the period	\$ -	\$ -	\$ -	\$ -
Total shareholders' equity	\$ 231,739	\$ 215,247	\$ 231,739	\$ 215,247

The accompanying notes are an integral part of these interim Consolidated Financial Statements.

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Consolidated Statements of Cash Flows (Unaudited)

(thousands of Canadian dollars)

	April 30	April 30
For the six months ended	2019	2018
Cash provided by (used in):		
Operations:		
Net income	\$ 9,828	\$ 8,232
Adjustments to determine net cash flows:		
Items not involving cash:		
Provision (recovery) for credit losses	(700)	15
Income tax provision	3,713	3,122
Interest income	(43,084)	(38,432)
Interest expense	16,901	13,605
Amortization of property and equipment	295	264
Interest received	41,771	36,782
Interest paid	(18,190)	(15,450)
Change in operating assets and liabilities:		
Loans	5,045	(42,016)
Deposits	(10,968)	19,809
Change in other assets and liabilities	(4,649)	701
	(38)	(13,368)
Investing:		
Proceeds from sale and maturity of securities	-	255
Purchase of property and equipment	(108)	(340)
	(108)	(85)
Financing:		
Repayment of subordinated notes (note 6)	(10,000)	-
Issuance of subordinated notes (note 6)	4,875	-
Dividends paid	(1,734)	(1,522)
Income taxes paid	(686)	(714)
	(7,545)	(2,236)
Change in cash	(7,691)	(15,689)
Cash, beginning of the period	129,781	159,909
Cash, end of the period	\$ 122,090	\$ 144,220

The accompanying notes are an integral part of these interim Consolidated Financial Statements.

VERSABANK

Notes to Interim Consolidated Financial Statements (Unaudited)

Three month & six month periods ended April 30, 2019 and 2018

1. Reporting entity:

VersaBank (the “Bank”) operates as a Schedule I bank under the *Bank Act (Canada)* and is regulated by the Office of the Superintendent of Financial Institutions (“OSFI”). The Bank, whose shares trade on the Toronto Stock Exchange, provides commercial lending services to select niche markets in Canada.

The Bank is incorporated and domiciled in Canada, and maintains its registered office at Suite 2002, 140 Fullarton Street, London, Ontario, Canada, N6A 5P2.

2. Basis of preparation:

a) Statement of compliance:

These interim Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (IASB) and have been prepared in accordance with International Accounting Standard (“IAS”) 34 – *Interim Financial Reporting* and do not include all of the information required for full annual financial statements. These interim Consolidated Financial Statements should be read in conjunction with the Bank’s audited Consolidated Financial Statements for the year ended October 31, 2018.

The interim Consolidated Financial Statements for the three and six months ended April 30, 2019 and 2018 were approved by the Audit Committee of the Board of Directors on May 27, 2019.

b) Basis of measurement:

These interim Consolidated Financial Statements have been prepared on the historical cost basis except for securities that are measured at fair value in the Consolidated Balance Sheets (see note 3).

c) Functional and presentation currency:

These interim Consolidated Financial Statements are presented in Canadian dollars which is the Bank’s functional currency.

d) Use of estimates and judgments:

In preparing these interim Consolidated Financial Statements, management has exercised judgment and developed estimates in applying accounting policies and generating reported amounts of assets and liabilities at the date of the financial statements and income and expenses during the reporting period. Areas where significant judgment was applied were in the assessments of impairment of financial instruments. Estimates include the calculation of the allowance for credit losses and the measurement of deferred income taxes.

VERSABANK

Notes to Interim Consolidated Financial Statements (Unaudited)

Three month & six month periods ended April 30, 2019 and 2018

It is reasonably possible, on the basis of existing knowledge, that actual results may vary from that expected in the generation of these estimates. This could result in material adjustments to the carrying amounts of assets and/or liabilities affected in the future.

Estimates and their underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are applied prospectively once they are recognized.

3. Significant accounting policies and future accounting changes:

The accounting policies applied by the Bank in these interim Consolidated Financial Statements are the same as those applied by the Bank as at and for the year ended October 31, 2018 and are detailed in Note 3 of the Bank's 2018 audited Consolidated Financial Statements, except for changes to accounting policies resulting from the adoption of IFRS 9 (*Financial Instruments*) noted below.

There have been a number of standards and amendments that have been issued by the IASB that are not effective for the Bank's fiscal year end of October 31, 2019 and therefore have not been applied in preparing these interim consolidated financial statements. Expanded discussions on future accounting that may impact the Bank's future financial statements are detailed in Note 4 of the Bank's 2018 audited Consolidated Financial Statements.

a) Financial Instruments (IFRS 9)

IFRS 9 has resulted in changes in accounting policies related to the classification and measurement and impairment of financial assets, which includes the introduction of an expected credit loss ("ECL") impairment methodology and associated model for all financial assets and certain off-balance sheet loan commitments and guarantees. There are no significant changes in accounting policies for financial liabilities, derivative instruments and derecognition of financial assets and liabilities. This change in accounting policy was adopted retrospectively, with no restatement of comparatives. Refer to Note 17 – Transition to IFRS 9, in the Bank's First Quarter 2019 Interim Consolidated Financial Statements for impact to the opening balance sheet as at November 1, 2018.

Classification and Measurement

Under IFRS 9, all financial assets must be classified at initial recognition as a function of the financial asset's contractual cash flow characteristics and the business model under which the financial asset is managed. All financial assets are required to be measured at fair value with the exception of financial assets measured at amortized cost. Financial assets are required to be reclassified when the business model under which they are managed has changed. Any reclassifications are applied prospectively from the reclassification date. All financial liabilities are measured at amortized cost unless elected otherwise.

VERSABANK

Notes to Interim Consolidated Financial Statements (Unaudited)

Three month & six month periods ended April 30, 2019 and 2018

Debt instruments

Financial assets that are debt instruments are categorized into one of the following measurement categories:

- amortized cost;
- fair value through other comprehensive income (“FVOCI”);
- fair value through profit and loss (“FVTPL”).

The characterization of a debt instrument’s cashflows is determined through a solely payment of principal and interest (“SPPI”) test. The SPPI test is conducted to identify whether the contractual cash flows of a debt instrument are in fact solely payments of principal and interest and are consistent with a basic lending arrangement. In the context of the SPPI test, “Principal” is defined as the fair value of the debt instrument at origination or initial recognition, which may change over the life of the instrument as a function of a number of variables including principal repayments, prepayments, or amortization of a premium/discount. In the context of the SPPI test “Interest” is defined as the consideration for the time value of money and credit risk. The rationale for the SPPI test is to ensure that debt instruments that include structural features that are incongruent with a basic lending arrangement, such as conversion options, are classified as and measured at FVTPL.

The key business activities or attributes that are considered by the Bank in the definition of the business model for the purpose of classifying financial instruments are as follows:

- the business purpose of the portfolio;
- the level of typical sales activity in the portfolio; and,
- the nature of the risks that are being managed in the administration of the portfolio.

Debt instruments measured at amortized cost

Debt instruments with contractual cash flows that meet the SPPI test and are managed on a hold to collect basis are measured at amortized cost. These financial instruments are recognized initially at fair value plus direct and incremental transaction costs, and are subsequently measured at amortized cost, using the effective interest rate method, net of an allowance for expected credit losses. The effective interest rate is the rate that discounts estimated future cashflows through the expected life of the instrument to the gross carrying amount of the instrument. Amortized cost is calculated as a function of the effective interest rate, taking into account any discount or premium on acquisition, transaction costs and fees. Amortization of these costs is included in interest income in the consolidated statement of income.

Debt instruments measured at FVOCI

Debt instruments measured at FVOCI have contractual cash flows that meet the SPPI test and are managed on a hold to collect and for sale basis. FVOCI debt instruments are measured initially at fair value, plus direct and incremental transaction costs. Subsequent to initial recognition, unrealized gains and losses on debt instruments measured at FVOCI are recorded in other comprehensive income (“OCI”). Premiums,

VERSABANK

Notes to Interim Consolidated Financial Statements (Unaudited)

Three month & six month periods ended April 30, 2019 and 2018

discounts and related transaction costs are amortized over the expected life of the instrument to interest income in the consolidated statement of income using the effective interest rate method.

Impairment of debt instruments measured at FVOCI is calculated using the expected credit loss approach. The allowance does not reduce the carrying amount of the asset in the consolidated balance sheet, which remains at its fair value. Instead, an amount equal to the allowance that would arise if the assets were measured at amortized cost is recognized in OCI with a corresponding charge to net provision for credit losses in the consolidated statement of income.

Cumulative gains and losses previously recognized in OCI, including accumulated allowances, are transferred from AOCI to the consolidated statement of income when the debt instrument is sold.

Debt instruments measured at FVTPL

Trading financial instruments are mandatorily measured at FVTPL as they are held for trading purposes or are part of a managed portfolio with a pattern of short-term profit taking. Non-trading financial instruments are also mandatorily measured at fair value if their contractual cash flow characteristics do not meet the SPPI test or if they are managed together with other financial instruments on a fair value basis. Trading and non-trading financial instruments mandatorily measured at FVTPL are re-measured at fair value as at the consolidated balance sheet date. Gains and losses realized on disposition and unrealized gains and losses from changes in fair value are included in non-interest income as gains (losses) from financial instruments measured/designated at FVTPL. Interest income and dividends earned on trading and non-trading financial instruments are included in interest income.

Derivatives are measured at FVTPL under IFRS 9, except to the extent that they are designated in a hedging relationship. Notwithstanding the above, the Bank has elected, as permitted, to continue to maintain IAS 39 hedge accounting requirements.

Equity instruments

Equity instruments are measured at FVTPL unless an irrevocable designation is made, at initial recognition to measure them at FVOCI. Gains or losses from changes in the fair value of equity financial instruments designated at FVOCI, including any related foreign exchange gains or losses, are recognized in OCI. In contrast to asset-for-sale equity securities under IAS 39, amounts recognized in OCI will not be subsequently recycled to profit or loss, with the exception of dividends. Dividends received are recorded in interest income in the consolidated statement of income. Cumulative gains or losses upon derecognition of the equity instrument will be transferred within equity from AOCI to retained earnings.

Financial assets and liabilities designated at FVTPL

Financial assets and financial liabilities classified in this category are those that have been designated at FVTPL by the Bank on initial recognition.

VERSABANK

Notes to Interim Consolidated Financial Statements (Unaudited)

Three month & six month periods ended April 30, 2019 and 2018

Financial assets are designated at FVTPL if doing so eliminates or significantly reduces an accounting mismatch which would otherwise arise.

Financial liabilities are designated at FVTPL when one of the following criteria is met:

- The designation eliminates or significantly reduces an accounting mismatch which would otherwise arise; or
- The financial liability contains one or more embedded derivatives which significantly modifies the cash flows otherwise required.

Financial assets and financial liabilities designated at FVTPL are recorded in the consolidated balance sheet at fair value. For assets designated at FVTPL, changes in fair value are recognized as other income in the consolidated statement of income. For liabilities designated at fair value through profit or loss, all changes in fair value are recognized as other income in the consolidated statement of income, except for changes in fair value arising from changes in the Bank's own credit risk which are recognized in OCI. Amounts recognized in OCI are not subsequently reclassified to the consolidated statement of income upon derecognition of the liabilities.

Impairment – Allowance for Expected Credit Losses

The Bank must maintain an allowance for expected credit losses that is adequate, in management's opinion, to absorb all credit related losses in the Bank's lending and treasury portfolios. The Bank's allowance for expected credit losses is estimated using the ECL methodology and is comprised of expected credit losses recognized on all financial assets that are debt instruments, classified either as amortized cost or as FVOCI, and on all loan commitments and financial guarantees that are not measured at FVTPL.

Expected credit losses represent unbiased and probability-weighted estimates that are modeled as a function of a range of possible outcomes as well as the time value of money, and reasonable and supportable information about past events, current conditions and forecasts of future economic conditions, or more specifically forward-looking information ("FLI") (see *Forward-Looking Information* below).

The Bank's ECL or impairment models estimate 12 months of expected credit losses, ("TMECL") for performing loans that have not experienced a significant increase in credit risk, ("SICR") since initial recognition. Further, the ECL impairment model estimates lifetime expected credit losses, ("LTECL") on performing loans that have experienced a SICR since initial recognition. Individual allowances are estimated for loans that are determined to be credit impaired.

Under the ECL methodology, loans or other financial instruments that have not experienced a SICR since initial recognition are designated as stage 1, while loans or financial instruments that have experienced a SICR since initial recognition are designated as stage 2, and loans or financial instruments that are determined to be credit impaired are designated as stage 3.

VERSABANK

Notes to Interim Consolidated Financial Statements (Unaudited)

Three month & six month periods ended April 30, 2019 and 2018

Assessment of significant increase in credit risk

At each reporting date, the Bank assesses whether or not there has been a SICR for loans since initial recognition by comparing, at the reporting date, the risk of default occurring over the remaining expected life against the risk of default at initial recognition.

The determination of a SICR is a function primarily of loan product type and the associated risk profile of same. The principal factors considered in making this determination include relative changes in the Bank's internal risk rating assignment, the loan's internal watchlist status, and the loan's delinquency status.

Quantitative models may not always be able to capture all reasonable and supportable information that may indicate a SICR. As a result, qualitative factors may be assessed to supplement such a gap. Examples include changes in adjudication criteria for a particular group of borrowers or changes in portfolio composition.

With regards to delinquency and monitoring, there is a rebuttable presumption that the credit risk of a loan or other financial instrument has increased since initial recognition when contractual payments are more than 60 days delinquent. The Bank chose to use 60 days delinquency as an appropriate indicator of increased credit risk as it serves as a stable early warning indicator that the cashflows associated with the loan or other financial instrument under consideration may be in jeopardy and may not be realized by the Bank under the contractual repayment terms.

Expected credit loss model - Estimation of expected credit losses

Expected credit losses are an estimate of a loan's expected cash shortfalls discounted at the effective interest rate, where a cash shortfall is the difference between the contractual cash flows that are due to the Bank and the cash flows that the Bank actually expects to receive. The ECL calculation is a function of the credit risk parameters; probability of default, loss given default, and exposure at default associated with each loan, sensitized to future market and macroeconomic conditions through the incorporation of FLI derived from multiple economic forecast scenarios, including baseline, upside, and downside scenarios.

For clarity:

- The probability of default ("PD") for a loan or a financial instrument is an estimate of the likelihood of default of that instrument over a given time horizon;
- The loss given default ("LGD") for a loan or financial instrument is an estimate of the loss arising in the case where a default of that instrument occurs at a given time or over a given period; and
- The exposure at default ("EAD") for a loan or financial instrument is an estimate of the Bank's exposure derived from that instrument at a future default date.

The Bank's ECL model develops contractual cashflow profiles for loans as a function of a number of underlying assumptions and a broad range of input variables. The expected cashflow schedules are subsequently derived from the contractual cashflow schedules, adjusted for incremental default amounts, forgone interest, and recovery amounts.

VERSABANK

Notes to Interim Consolidated Financial Statements (Unaudited)

Three month & six month periods ended April 30, 2019 and 2018

Incremental default amounts are estimated as a function of the credit risk parameters PD, LGD and EAD, sensitized to future market and macroeconomic conditions through the incorporation of FLI derived from multiple economic forecast scenarios, including baseline, upside, and downside scenarios.

The finalized contractual and expected cashflow schedules are subsequently discounted at the effective interest rate to determine the expected cash shortfall or allowance for expected credit losses for each individual loan or financial instrument.

Individual allowances are estimated for loans and other financial instruments that are determined to be credit impaired and that have been designated as stage 3. A loan is classified as credit impaired when the Bank becomes aware that all of, or a portion of the contractual cashflows associated with the loan may be in jeopardy and as a result may not be realized by the Bank under the repayment schedule set out in the contractual terms associated with the loan. More specifically, loans for which interest or principal is contractually past due 90 days are automatically recognized as impaired.

Forward-Looking Information

The IFRS 9 standard requires consideration of past events, current market conditions and reasonable, supportable information about future economic conditions that is available without undue cost and effort, in the estimation of the expected credit losses for loans. More specifically, under IFRS 9 expected credit losses represents an unbiased, probability-weighted estimate of the present value of cash shortfalls (i.e., the weighted average of credit losses, with the respective risks of a default occurring in a given time period used as the weights). Additionally, IFRS 9 stipulates that future economic conditions are to be based on an unbiased, probability-weighted assessment of possible future outcomes. The estimation and application of forward-looking information in an attempt to capture the impact of future economic conditions requires significant judgement.

The Bank has elected to incorporate the impact of future economic conditions, or more specifically forward looking information into the estimation of expected credit losses at the credit risk parameter level. This is accomplished via the credit risk parameter models and proxy datasets that the Bank utilizes to develop PD and LGD term structure forecasts for its loans. The Bank has sourced credit risk modeling systems and forecast economic data from a well-established, third party for the purpose of computing forward-looking risk parameters under multiple economic scenarios that consider both market-wide and idiosyncratic factors and influences. These systems are integrated with the Bank's internally developed ECL models. Given that the Bank has experienced very limited historical losses and, therefore, does not have available statistically significant loss data inventory for use in developing forward looking expected credit loss trends, the integration of unbiased, third party forward-looking risk parameter modeling systems is particularly important for the Bank in the context of the estimation of expected credit losses.

The Bank utilizes macroeconomic indicator data derived from three macroeconomic scenarios, those being a baseline scenario, an upside scenario, and a downside scenario in order to mitigate volatility in the estimation of expected credit losses as well as to satisfy the IFRS 9 requirement that future economic conditions are to be based on an unbiased, probability-weighted assessment of possible future outcomes. More specifically, the macroeconomic indicators set out in the three scenarios are used as inputs for the

VERSABANK

Notes to Interim Consolidated Financial Statements (Unaudited)

Three month & six month periods ended April 30, 2019 and 2018

credit risk parameter models utilized by the Bank to sensitize the individual, PD and LGD term structure forecasts to the respective macroeconomic trajectory set out in each of the scenarios. The weighted average of the individual, sensitized PD and LGD values that comprise each individual term structure forecast is subsequently computed to define unbiased PD and LGD term structure forecasts, which in turn are applied as inputs to the Bank's internal ECL model in the estimation of expected credit losses for the Bank's loans. Macroeconomic indicator data derived from the baseline, upside and downside scenarios is also utilized in the development of credit risk parameter proxy datasets applied to the Bank's consumer loan and small and medium enterprise (SME) loan portfolios.

The macroeconomic indicator data utilized by the Bank for the purpose of sensitizing PD and PGD term structure data to forward economic conditions include, but are not limited to: real GDP, the national unemployment rate, long term interest rates, the consumer price index, and the price of oil. These specific macroeconomic indicators were selected in an attempt to ensure that the spectrum of fundamental macroeconomic influences on the key drivers of the credit risk profile of the Bank's balance sheet, including: corporate, consumer and real estate market dynamics; corporate, consumer and SME borrower performance; geography; as well as collateral value trajectories, are appropriately captured and incorporated into the Bank's forward macroeconomic sensitivity analysis.

Modified Financial Instruments

If the terms of a financial instrument are modified or an existing financial instrument is replaced with a new one, an assessment is made to determine if the financial instrument should be derecognized. Where the modification does not result in derecognition, the date of origination continues to be used to determine SICR. Where modification results in derecognition, the modified financial instrument is considered to be a new instrument.

Hedge Accounting

The Bank has elected, as permitted, to continue to apply the hedge accounting requirements of IAS 39.

b) Revenues from contracts with customers (IFRS 15)

IFRS 15 establishes a comprehensive framework for determining whether, how much, and when, revenue is recognised. It replaced IAS 18 Revenue, IAS 11 Construction Contracts and related interpretations. The new standard became effective for the Bank's fiscal year beginning November 1, 2018. The amount of non-interest fees and other income earned by the Bank is not significant and therefore not materially impacted by the adoption of this standard.

VERSABANK

Notes to Interim Consolidated Financial Statements (Unaudited)

Three month & six month periods ended April 30, 2019 and 2018

4. Loans:

a) Summary of loans and allowance for credit losses:

(thousands of Canadian dollars)

	April 30 2019	October 31 2018	April 30 2018
Commercial real estate	\$ 601,395	\$ 594,627	\$ 558,061
Non-commercial real estate	50,842	91,517	105,420
Corporate and public sector	47,574	50,922	57,409
Structured finance	923,715	889,822	839,853
	1,623,526	1,626,888	1,560,743
Allowance for credit losses	(1,953)	(2,759)	(2,440)
Accrued interest	6,543	6,897	6,121
Total loans, net of allowance for credit losses	\$ 1,628,116	\$ 1,631,026	\$ 1,564,424

The following table provides a summary of loan amounts, ECL allowance, and expected loss ("EL") rates by lending asset category:

	As at April 30, 2019			
(thousands of Canadian dollars)	Stage 1	Stage 2	Stage 3	Total
Commercial real estate	\$ 531,500	\$ 45,026	\$ 24,869	\$ 601,395
ECL allowance	1,047	202	-	1,249
EL %	0.20%	0.45%	-	0.21%
Non-commercial real estate	\$ 50,842	\$ -	\$ -	\$ 50,842
ECL allowance	84	-	-	84
EL %	0.17%	-	-	0.17%
Corporate and public finance	\$ 46,685	\$ 262	\$ 627	\$ 47,574
ECL allowance	58	-	400	458
EL %	0.12%	-	63.80%	0.96%
Structured finance	\$ 919,982	\$ 3,725	\$ 8	\$ 923,715
ECL allowance	161	1	-	162
EL %	0.02%	0.03%	0.00%	0.02%
Total Net Loans	\$ 1,549,009	\$ 49,013	\$ 25,504	\$ 1,623,526
Total ECL allowance	1,350	203	400	1,953
Total EL %	0.09%	0.41%	1.57%	0.12%

VERSABANK

Notes to Interim Consolidated Financial Statements (Unaudited)

Three month & six month periods ended April 30, 2019 and 2018

The following table provides a reconciliation of the Bank's ECL allowance by lending asset category for the three months ended April 30, 2019:

(thousands of Canadian dollars)	Stage 1	Stage 2	Stage 3	Total
Commercial real estate				
Balance at beginning of period	\$ 1,187	\$ 269	\$ -	1,456
Transfer in (out) to Stage 1	1	(1)	-	-
Transfer in (out) to Stage 2	(8)	8	-	-
Transfer in (out) to Stage 3	-	(97)	97	-
Net remeasurement of loss allowance	(211)	23	(97)	(285)
Loan originations	98	-	-	98
Derecognitions and maturities	(20)	-	-	(20)
Provision for (recovery of) credit losses	(140)	(67)	-	(207)
Write-offs	-	-	-	-
Recoveries	-	-	-	-
Balance at end of period	\$ 1,047	\$ 202	\$ -	1,249
Non-commercial real estate				
Balance at beginning of period	\$ 133	\$ -	\$ -	133
Transfer in (out) to Stage 1	-	-	-	-
Transfer in (out) to Stage 2	-	-	-	-
Transfer in (out) to Stage 3	-	-	-	-
Net remeasurement of loss allowance	(49)	-	-	(49)
Loan originations	-	-	-	-
Derecognitions and maturities	-	-	-	-
Provision for (recovery of) credit losses	(49)	-	-	(49)
Write-offs	-	-	-	-
Recoveries	-	-	-	-
Balance at end of period	\$ 84	\$ -	\$ -	84
Corporate and public sector				
Balance at beginning of period	\$ 64	\$ -	\$ 400	464
Transfer in (out) to Stage 1	-	-	-	-
Transfer in (out) to Stage 2	-	-	-	-
Transfer in (out) to Stage 3	-	-	-	-
Net remeasurement of loss allowance	(6)	-	-	(6)
Loan originations	-	-	-	-
Derecognitions and maturities	-	-	-	-
Provision for (recovery of) credit losses	(6)	-	-	(6)
Write-offs	-	-	-	-
Recoveries	-	-	-	-
Balance at end of period	\$ 58	\$ -	400	458
Structured finance				
Balance at beginning of period	\$ 310	\$ 1	\$ -	311
Transfer in (out) to Stage 1	16	(16)	-	-
Transfer in (out) to Stage 2	(56)	56	-	-
Transfer in (out) to Stage 3	-	-	-	-
Net remeasurement of loss allowance	(921)	(30)	-	(951)
Loan originations	1,127	-	-	1,127
Derecognitions and maturities	(315)	(10)	-	(325)
Provision for (recovery of) credit losses	(149)	-	-	(149)
Write-offs	-	-	-	-
Recoveries	-	-	-	-
Balance at end of period	\$ 161	\$ 1	\$ -	162
Total balance at end of period	\$ 1,350	\$ 203	\$ 400	1,953

VERSABANK

Notes to Interim Consolidated Financial Statements (Unaudited)

Three month & six month periods ended April 30, 2019 and 2018

The following table provides a reconciliation of the Bank's ECL allowance by lending asset category for the six months ended April 30, 2019:

(thousands of Canadian dollars)	Stage 1	Stage 2	Stage 3	Total
Commercial real estate				
Balance at beginning of period	\$ 1,257	\$ 348	\$ -	1,605
Transfer in (out) to Stage 1	22	(22)	-	-
Transfer in (out) to Stage 2	(9)	9	-	-
Transfer in (out) to Stage 3	-	(177)	177	-
Net remeasurement of loss allowance	(305)	45	(177)	(437)
Loan originations	157	-	-	157
Derecognitions and maturities	(75)	(1)	-	(76)
Provision for (recovery of) credit losses	(210)	(146)	-	(356)
Write-offs	-	-	-	-
Recoveries	-	-	-	-
Balance at end of period	\$ 1,047	\$ 202	\$ -	1,249
Non-commercial real estate				
Balance at beginning of period	\$ 151	\$ -	\$ -	151
Transfer in (out) to Stage 1	-	-	-	-
Transfer in (out) to Stage 2	-	-	-	-
Transfer in (out) to Stage 3	-	-	-	-
Net remeasurement of loss allowance	(67)	-	-	(67)
Loan originations	-	-	-	-
Derecognitions and maturities	-	-	-	-
Provision for (recovery of) credit losses	(67)	-	-	(67)
Write-offs	-	-	-	-
Recoveries	-	-	-	-
Balance at end of period	\$ 84	\$ -	\$ -	84
Corporate and public sector				
Balance at beginning of period	\$ 81	\$ -	\$ 400	481
Transfer in (out) to Stage 1	-	-	-	-
Transfer in (out) to Stage 2	-	-	-	-
Transfer in (out) to Stage 3	-	-	-	-
Net remeasurement of loss allowance	(25)	-	-	(25)
Loan originations	2	-	-	2
Derecognitions and maturities	-	-	-	-
Provision for (recovery of) credit losses	(23)	-	-	(23)
Write-offs	-	-	-	-
Recoveries	-	-	-	-
Balance at end of period	\$ 58	\$ -	\$ 400	458
Structured finance				
Balance at beginning of period	\$ 415	\$ 1	\$ -	416
Transfer in (out) to Stage 1	35	(35)	-	-
Transfer in (out) to Stage 2	(92)	92	-	-
Transfer in (out) to Stage 3	-	-	-	-
Net remeasurement of loss allowance	(2,124)	(35)	-	(2,159)
Loan originations	2,596	-	-	2,596
Derecognitions and maturities	(669)	(22)	-	(691)
Provision for (recovery of) credit losses	(254)	-	-	(254)
Write-offs	-	-	-	-
Recoveries	-	-	-	-
Balance at end of period	\$ 161	\$ 1	\$ -	162
Total balance at end of period	\$ 1,350	\$ 203	\$ 400	1,953

VERSABANK

Notes to Interim Consolidated Financial Statements (Unaudited)

Three month & six month periods ended April 30, 2019 and 2018

The Bank holds security against the majority of its loans in the form of either mortgage interests over property, other registered securities over assets, guarantees and holdbacks on loan and lease receivables (see note 8).

The following table provides the allowance for credit losses under IAS 39 for the three months and six months ended April 30, 2018:

(thousands of Canadian dollars)

				April 30 2018 Total
For the three months ended	Collective	Individual		Allowance
Balance, beginning of the period	\$ 2,290	\$ 200	\$	2,490
Provision (recovery) for credit losses	(50)	-		(50)
Write-offs	-	-		-
Balance, end of the period	\$ 2,240	\$ 200	\$	2,440

				April 30 2018 Total
For the six months ended	Collective	Individual		Allowance
Balance, beginning of the period	\$ 2,225	\$ 200	\$	2,425
Provision (recovery) for credit losses	15	-		15
Write-offs	-	-		-
Balance, end of the period	\$ 2,240	\$ 200	\$	2,440

b) Impaired loans:

At April 30, 2019, impaired loans were \$25.5 million (October 31, 2018 - \$627,000).

VERSABANK

Notes to Interim Consolidated Financial Statements (Unaudited)

Three month & six month periods ended April 30, 2019 and 2018

5. Other assets:

(thousands of Canadian dollars)

	April 30 2019	October 31 2018	April 30 2018
Accounts receivable	\$ 409	\$ 489	\$ 448
Funds held for securitization liabilities	6,519	6,078	5,648
Prepaid expenses and other	5,718	4,949	6,084
Property and equipment	8,203	8,390	8,096
Deferred income tax asset	15,098	18,400	21,777
	<u>\$ 35,947</u>	<u>\$ 38,306</u>	<u>\$ 42,053</u>

6. Subordinated notes payable:

(thousands of Canadian dollars)

	April 30 2019	October 31 2018	April 30 2018
Ten year term, unsecured, subordinated note payable. Principal amount of \$5 million, interest rate of 10% (effective interest rate of 10.41%), maturing March 2029.	\$ 4,876	\$ -	\$ -
Ten year term, unsecured, callable subordinated note payable. Principal amount of \$10 million, interest rate of 8% (effective interest rate of 8.77%), redeemed March 2019.	\$ -	\$ 9,844	\$ 9,814
	<u>\$ 4,876</u>	<u>\$ 9,844</u>	<u>\$ 9,814</u>

In March 2019, the Bank redeemed the \$10.0 million subordinate note payable. In the same month the Bank completed a private placement of non-viability contingent capital ("NVCC") compliant debentures in the principal amount of \$5.0 million, of which \$500,000 was issued to a related party (see note 13). Issue costs associated with the private placements were \$125,000.

7. Securitization liabilities:

Securitization liabilities include amounts payable to counterparties for cash received upon initiation of securitization transactions, accrued interest on amounts payable to counterparties, and the unamortized balance of deferred costs and discounts which arose upon initiation of the securitization transactions.

The amounts payable to counterparties bear interest at rates ranging from 3.55% - 3.95% and mature in 2020. Securitized residential insured mortgages and other assets are pledged as collateral for these liabilities.

VERSABANK

Notes to Interim Consolidated Financial Statements (Unaudited)

Three month & six month periods ended April 30, 2019 and 2018

8. Other liabilities:

(thousands of Canadian dollars)

	April 30 2019	October 31 2018	April 30 2018
Accounts payable and other	\$ 2,681	\$ 3,474	\$ 1,886
Cash collateral and amounts held in escrow	5,870	5,343	4,393
Holdbacks payable on loan and lease receivables	92,631	96,161	92,158
	<u>\$ 101,182</u>	<u>\$ 104,978</u>	<u>\$ 98,437</u>

9. Share capital:

a) Common shares:

At April 30, 2019, there were 21,123,559 (October 31, 2018 – 21,123,559) common shares outstanding.

b) Preferred shares:

At April 30, 2019, there were 1,461,460 (October 31, 2018 – 1,461,460) Series 1 preferred shares and 1,681,320 (October 31, 2018 – 1,681,320) Series 3 preferred shares outstanding. These shares are Basel III compliant, non-cumulative rate reset preferred shares which include NVCC provisions. As a result, these shares qualify as Additional Tier 1 Capital (see note 14).

c) Stock options:

At April 30, 2019, there were 43,851 common share stock options outstanding (October 31, 2018 – 43,851).

10. Income taxes:

Income taxes for the three months and six months ended April 30, 2019 was \$1.9 million (April 30, 2018 - \$1.6 million) and \$3.7 million (April 30, 2018 - \$3.1 million) respectively. The Bank's statutory federal and provincial income tax rate is approximately 27% (2018 – 27%). The effective rate is affected by certain items not being taxable or deductible for income tax purposes.

VERSABANK

Notes to Interim Consolidated Financial Statements (Unaudited)

Three month & six month periods ended April 30, 2019 and 2018

11. Income per common share:

(thousands of Canadian dollars)

	for the three months ended		for the six months ended	
	April 30 2019	April 30 2018	April 30 2019	April 30 2018
Net income	\$ 4,896	\$ 4,256	\$ 9,828	\$ 8,232
Less: dividends on preferred shares	(550)	(550)	(1,100)	(1,100)
	4,346	3,706	8,728	7,132
Average number of common shares outstanding	21,123,559	21,123,559	21,123,559	21,123,559
Income per common share:	\$ 0.21	\$ 0.18	\$ 0.41	\$ 0.34

The Series 1 and Series 3 NVCC preferred shares are contingently issuable shares and do not have a dilutive impact.

12. Commitments and contingencies:

The amount of credit related commitments represents the maximum amount of additional credit that the Bank could be obligated to extend.

(thousands of Canadian dollars)

	April 30 2019	October 31 2018	April 30 2018
Loan commitments	\$ 230,824	\$ 167,624	\$ 215,091
Letters of credit	37,857	42,530	50,553
	\$ 268,681	\$ 210,154	\$ 265,644

13. Related party transactions:

The Bank's Board of Directors and Senior Executive Officers represent key management personnel.

The Bank has loans to employees and key management personnel. At April 30, 2019, amounts due from related parties totalled \$1.4 million (October 31, 2018 - \$672,000). The interest rates charged on these loans are similar to those charged in an arms-length transaction. Interest income earned on the above loans for the three months and six months ended April 30, 2019 was \$13,000 (April 30, 2018 - \$6,000) and \$21,000 (April 30, 2018 - \$12,000) respectively. All loans issued to key management personnel were current as at April 30, 2019 and 2018.

In March 2019, the Bank issued a \$500,000 subordinated note payable to a key management personnel which bears an interest rate of 10% and matures in March 2029 (note 6).

VERSABANK

Notes to Interim Consolidated Financial Statements (Unaudited)

Three month & six month periods ended April 30, 2019 and 2018

14. Capital management:

a) Overview:

The Bank's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also important and the Bank recognizes the need to maintain a balance between the higher returns that might be possible with greater leverage and the advantages and security afforded by a sound capital position.

OSFI sets and monitors capital requirements for the Bank. Capital is managed in accordance with policies and plans that are regularly reviewed and approved by the Board of Directors and take into account forecasted capital needs and conditions in the financial markets.

The goal is to maintain adequate regulatory capital to be considered well capitalized, protect depositors and provide capacity for internally generated growth and strategic opportunities that do not otherwise require accessing the public capital markets, all the while providing a satisfactory return to shareholders. The Bank's regulatory capital is comprised of share capital, retained earnings and accumulated other comprehensive income (Common Equity Tier 1 capital), preferred shares (Additional Tier 1 capital) and subordinated notes (Tier 2 capital).

The Bank monitors its capital adequacy and related capital metrics on a daily basis and has policies that set out internal thresholds for same. These capital metrics consist of the leverage ratio and the risk-based capital ratios.

During the period ended April 30, 2019, there were no material changes in the Bank's management of capital.

b) Risk-Based Capital Ratios:

The Basel Committee on Banking Supervision has published the Basel III rules supporting more stringent global standards on capital adequacy and liquidity ("Basel III").

OSFI requires that all Canadian banks must comply with the Basel III standards on an "all-in" basis that became effective January 1, 2013 for the purpose of determining their risk-based capital ratios. Required minimum regulatory capital ratios are a 7.0% Common Equity Tier 1 ("CET1") capital ratio and effective January 1, 2014, an 8.5% Tier 1 capital ratio and 10.5% total capital ratio, all of which include a 2.50% capital conservation buffer. The Basel III rules provide for "transitional" adjustments whereby certain aspects of the new rules will be phased in between 2013 and 2019. The only available transition allowed by OSFI for capital ratios is related to the 10 year phase out of non-qualifying capital instruments.

OSFI also requires banks to measure capital adequacy in accordance with guidelines for determining risk adjusted capital and risk-weighted assets including off-balance sheet credit instruments as specified in the Basel III regulations. Based on the deemed credit risk for each type of asset, assets held by the Bank are

VERSABANK

Notes to Interim Consolidated Financial Statements (Unaudited)

Three month & six month periods ended April 30, 2019 and 2018

assigned a weighting of 0% to 150% to determine the Bank's risk weighted equivalent assets and its risk-based capital ratios.

The Bank's risk-based capital ratios are calculated as follows:

(thousands of Canadian dollars)

	April 30, 2019		October 31, 2018	
	"All-in"	"Transitional"	"All-in"	"Transitional"
Common Equity Tier 1 (CET1) capital				
Directly issued qualifying common share capital	\$ 152,757	\$ 152,757	\$ 152,757	\$ 152,757
Retained earnings	49,645	49,645	41,473	41,473
Accumulated other comprehensive income	-	-	-	-
CET1 capital before regulatory adjustments	202,402	202,402	194,230	194,230
Total regulatory adjustments to CET1	(16,872)	(13,497)	(20,175)	(16,140)
Common Equity Tier 1 capital	\$ 185,530	\$ 188,905	\$ 174,055	\$ 178,090
Additional Tier 1 (AT1) capital				
Directly issued qualifying AT1 instruments	\$ 29,337	\$ 29,337	\$ 29,337	\$ 29,337
Tier 1 capital	\$ 214,867	\$ 218,242	\$ 203,392	\$ 207,427
Tier 2 capital				
Directly issued capital instruments subject to phase out from Tier 2	\$ 5,000	\$ 5,000	\$ 10,000	\$ 10,000
Tier 2 capital before regulatory adjustments	5,000	5,000	10,000	10,000
Total regulatory adjustments to Tier 2 capital	-	-	(6,000)	(6,000)
Tier 2 capital	\$ 5,000	\$ 5,000	\$ 4,000	\$ 4,000
Total regulatory capital	\$ 219,867	\$ 223,242	\$ 207,392	\$ 211,427
Total risk-weighted assets	\$ 1,524,228	\$ 1,527,602	\$ 1,502,549	\$ 1,506,584
Capital ratios				
CET1 Ratio	12.17%	12.37%	11.58%	11.82%
Tier 1 Capital Ratio	14.10%	14.29%	13.54%	13.77%
Total Capital Ratio	14.42%	14.61%	13.80%	14.03%

VERSABANK

Notes to Interim Consolidated Financial Statements (Unaudited)

Three month & six month periods ended April 30, 2019 and 2018

c) Leverage Ratio:

The leverage ratio, which is prescribed under the Basel III Accord, is a supplementary measure to the risk-based capital requirements and is defined as the ratio of Tier 1 capital to its total exposures. The leverage ratio is calculated as follows:

(thousands of Canadian dollars)

	April 30 2019	October 31 2018
On-balance sheet assets	\$ 1,796,192	\$ 1,809,130
Regulatory adjustments	(16,872)	(20,175)
Total on-balance sheet exposures	1,779,320	1,788,955
Off-balance sheet exposure at gross notional amount	\$ 268,681	\$ 210,154
Adjustments for conversion to credit equivalent amount	(168,745)	(123,345)
Off-balance sheet exposures	99,936	86,809
Tier 1 Capital	214,867	203,392
Total Exposures	1,879,256	1,875,764
Leverage Ratio	11.43%	10.84%

The Bank was in compliance with the leverage ratio prescribed by OSFI throughout the periods presented.

15. Interest rate position:

The Bank is subject to interest rate risk which is the risk that a movement in interest rates could negatively impact net interest margin, net interest income and the economic value of assets, liabilities and shareholders' equity. The following table provides the duration difference between the Bank's assets and liabilities and the potential after-tax impact of a 100 basis point shift in interest rates on the Bank's earnings during a 12 month period and the potential after-tax impact of a 100 basis point shift in interest rates on the Bank's shareholders' equity over a 60 month period if no remedial actions are taken.

	April 30, 2019		October 31, 2018	
	Increase 100 bps	Decrease 100 bps	Increase 100 bps	Decrease 100 bps
Impact on projected net interest income during a 12 month period	\$ 3,023	\$ (2,994)	\$ 2,829	\$ (2,802)
Impact on reported equity during a 60 month period	\$ (1,755)	\$ 1,842	\$ (2,707)	\$ 2,857
Duration difference between assets and liabilities (months)	-		0.5	

VERSABANK

Notes to Interim Consolidated Financial Statements (Unaudited)

Three month & six month periods ended April 30, 2019 and 2018

16. Fair Value of Financial Instruments:

Fair values are based on management's best estimates of market conditions and valuation policies at a certain point in time. The estimates are subjective and involve particular assumptions and matters of judgment and as such, may not be reflective of future fair values. The Bank's loans and deposits lack an available market as they are not typically exchanged and, therefore, they are not necessarily representative of amounts realizable upon immediate settlement. See Note 22 to the October 31, 2018 audited Consolidated Financial Statements for more information on fair values.

(thousands of Canadian dollars)	April 30, 2019		October 31, 2018	
	Book Value	Fair value of assets and liabilities	Book Value	Fair value of assets and liabilities
Assets				
Cash and cash equivalents	\$ 122,090	\$ 122,090	\$ 129,781	\$ 129,781
Securities	10,039	10,039	10,017	10,017
Loans	1,628,116	1,630,024	1,631,026	1,628,472
Other financial assets	6,928	6,928	6,567	6,567
Liabilities				
Deposits	\$ 1,425,057	\$ 1,423,988	\$ 1,437,431	\$ 1,412,286
Subordinated notes payable	4,876	5,000	9,844	10,000
Securitization liabilities	33,338	33,900	33,310	33,736
Other financial liabilities	101,182	101,182	104,978	104,978

CORPORATE INFORMATION

DIRECTORS

The Honourable Thomas A. Hockin, P.C., B.A, M.P.A., Ph.D., ICD.D
Chairman of the Board
Retired, former Executive Director of the International Monetary Fund

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Principal, Human Resources and Labour Relations, The Osborne Group

Robbert-Jan Brabander, M.Sc. and B.Sc. (Economics)
Managing Director of Bells & Whistles Communications, Inc.

David A. Bratton, B.A.(Hons), M.B.A., CHRP, FCMC
Retired, former President of Bratton Consulting Inc.

R.W. (Dick) Carter, FCPA, FCA, C. Dir
Retired, former Chief Executive Officer of the Crown Investments Corporation of Saskatchewan

Colin Litton, FCPA, FCA, ICD.D.
Retired, former senior partner of KPMG LLP

Susan T. McGovern, B.Sc.
Vice-President, External Relations and Advancement
Ontario Tech University

Paul G. Oliver, FCPA, FCA, ICD.D.
Retired, former senior partner of PricewaterhouseCoopers LLP

Avery Pennarun, B.A.Sc.(Hons) Computer Engineering
Information Technology Consultant

David R. Taylor, B.Sc. (Hons), M.B.A., F.I.C.B.
President and Chief Executive Officer, VersaBank

OFFICERS

David R. Taylor, B.Sc. (Hons), M.B.A., F.I.C.B.
President & CEO

Shawn Clarke, M.Eng., P.Eng., M.B.A.
CFO & Corporate Secretary

Michael Dixon, B.Comm., M.B.A.
Executive Head & SVP, e-Commerce

Ross P. Duggan
Executive Head & SVP, Commercial Lending

Nick Kristo, B.Comm., M.B.A.
Chief Credit Officer

Jonathan F.P. Taylor, B.B.A., CHRP
Executive Head & SVP, Deposit Services & Chief HR Officer

Jean-Paul Beker, B.A. (Economics), CFA
Vice President, Real Estate Lending

Steve Creery, B.A. (Economics)
Vice President, Credit

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Chief Internal Auditor

Wooi Koay, B.Comm., B.Sc.
Vice President, Information Technology

Aly Lalani, B.A., M.B.A., CPA, CA
Chief Risk Officer & Treasurer

Andy Min, B.A., CPA, CA
Vice President, Finance & Corporate Accounting

Scott A. Mizzen, B.A., LL.B.
Vice President, Real Estate Lending

David Thoms, B.A., M.B.A.
Vice President, Structured & Corporate Finance

SOLICITORS

Stikeman Elliott LLP
5300 Commerce Court West
199 Bay Street
Toronto, Ontario M5L 1B9

AUDITORS

KPMG LLP
500-475 2nd Avenue South
Saskatoon, Saskatchewan S7K 1P4

TRANSFER AGENT

Computershare Investor Services Inc.
100 University Avenue
Toronto, Ontario M5J 2Y1

BANK

Royal Bank of Canada
Main Branch, 154 1st Avenue South
Saskatoon, Saskatchewan S7K 1K2

STOCK EXCHANGE LISTING

Toronto Stock Exchange
Trading Symbol: VB

CORPORATE OFFICES

London Office

Suite 2002 - 140 Fullarton Street
London, Ontario N6A 5P2
Telephone: (519) 645-1919
Toll-free: (866) 979-1919
Fax: (519) 645-2060

Saskatoon Office

410 - 121 Research Drive
Saskatoon, Saskatchewan S7N 1K2
Telephone: (306) 244-1868
Toll-free: (800) 213-4282
Fax: (306) 244-4649

Vancouver Office

40733 Perth Drive
Garibaldi Highlands, British Columbia V0N 1T0
Telephone: (604) 984-7564
Fax: (604) 898-3442

INVESTOR RELATIONS

Toll Free Telephone: (800) 244-1509
Email: InvestorRelations@versabank.com
Web site: www.versabank.com