MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATIONS AND FINANCIAL CONDITION

This management's discussion and analysis ("MD&A") of operations and financial condition for the third quarter of Fiscal 2020, dated August 24, 2020, should be read in conjunction with the unaudited interim consolidated financial statements for the period ended July 31, 2020, which have been prepared in accordance with International Financial Reporting Standards ("IFRS"). This MD&A should also be read in conjunction with VersaBank's (the "Bank") MD&A and Audited Consolidated Financial Statements for the year ended October 31, 2019, which are available on the Bank's website at www.versabank.com and SEDAR at www.sedar.com. Except as discussed below, all other factors discussed and referred to in the MD&A for the year ended October 31, 2019, remain substantially unchanged.

HIGHLIGHTS

(unaudited)	for the three months ended		for the nine months ended	
	July 31	**July 31**	**July 31**	**July 31**
($CDN thousands except per share amounts)	**2020**	**2019**	**2020**	**2019**
Results of operations				
Interest income	$ 20,172	$ 22,958	$ 65,026	$ 66,042
Net interest income	12,384	14,059	40,417	40,242
Non-interest income	8	19	42	42
Total revenue	12,392	14,078	40,459	40,284
Provision (recovery) for credit losses	(44)	381	238	(319)
Non-interest expenses	6,410	6,860	20,014	20,225
Core cash earnings*	6,026	6,837	20,207	20,378
Core cash earnings per common share*	$ 0.29	$ 0.32	$ 0.96	$ 0.96
Net income	**4,369**	**4,963**	**14,659**	**14,791**
Income per common share:				
Basic	$ 0.18	$ 0.21	$ 0.62	$ 0.62
Diluted	$ 0.18	$ 0.21	$ 0.62	$ 0.62
Dividends paid on preferred shares	$ 542	$ 550	$ 1,626	$ 1,650
Dividends paid on common shares	$ 528	$ 422	$ 1,584	$ 1,056
Yield*	4.12%	5.10%	4.68%	4.92%
Cost of funds*	1.59%	1.98%	1.77%	1.92%
Net interest margin*	2.53%	3.12%	2.91%	3.00%
Return on average common equity*	6.90%	8.56%	8.04%	8.77%
Core cash return on average common equity*	9.89%	12.20%	11.46%	12.50%
Book value per common share*	$ 10.52	$ 9.77	$ 10.52	$ 9.77
Efficiency ratio*	51.73%	48.74%	49.47%	50.21%
Return on average total assets*	0.78%	0.98%	0.94%	0.98%
Gross impaired loans to total loans*	0.43%	1.58%	0.43%	1.58%
Provision (recovery) for credit losses as a % of average loans*	(0.01%)	0.02%	0.02%	(0.02%)
		as at		
Balance Sheet Summary				
Cash and securities	$ 353,794	$ 118,310	$ 353,794	$ 118,310
Loans, net of allowance for credit losses	1,547,761	1,613,811	1,547,761	1,613,811
Average loans*	1,571,365	1,620,964	1,571,025	1,622,419
Total assets	1,930,256	1,776,659	1,930,256	1,776,659
Average assets*	1,948,313	1,786,426	1,857,819	1,792,894
Deposits	1,565,334	1,398,286	1,565,334	1,398,286
Subordinated notes payable	4,887	4,879	4,887	4,879
Shareholders' equity	251,612	235,730	251,612	235,730
Capital ratios*				
Risk-weighted assets	$ 1,518,918	$ 1,504,445	$ 1,518,918	$ 1,504,445
Common Equity Tier 1 capital	214,272	191,235	214,272	191,235
Total regulatory capital	250,739	225,572	250,739	225,572
Common Equity Tier 1 (CET1) ratio	14.11%	12.71%	14.11%	12.71%
Tier 1 capital ratio	16.04%	14.66%	16.04%	14.66%
Total capital ratio	16.51%	14.99%	16.51%	14.99%
Leverage ratio	11.99%	11.90%	11.99%	11.90%

* A non-GAAP measure. See definition in "Non-GAAP and Additional GAAP Measures" in the Basis of Presentation section below.

Overview

VersaBank (the "Bank") adopted an electronic branchless model in 1993, becoming the world's first branchless financial institution. It holds a Canadian Schedule 1 chartered bank licence and obtains its deposits, and the majority of its loans and leases, electronically. VersaBank's Common Shares trade on the Toronto Stock Exchange under the symbol VB and its Series 1 Preferred Shares and Series 3 Preferred Shares trade under the symbols VB.PR.A and VB.PR.B, respectively.

VersaBank celebrated its 40th anniversary in the current quarter, starting out as Pacific Western Trust Corporation (often known as Pacific & Western Trust) in Saskatoon, SK which received its certificate of incorporation on June 11, 1979, and further, was granted a licence to operate on October 12, 1979.

In the early 1990s, recognizing the potential for technology to transform the way Canadian small and medium-size businesses do banking, VersaBank founder, President and CEO David Taylor had a vision to create a new kind of financial institution, a branchless bank. In less than a year, Mr. Taylor had established the world's first branchless financial institution – and the foundation for Canada's "Bank of the Future" – continually evolving its proprietary technology to efficiently and profitably address unmet needs in the Canadian financial market. In 2002, the now well-established financial institution was granted a Schedule 1 bank licence, the first in 18 years, at the time, becoming one of just 9 Canadian financial institutions with such a licence, significantly enhancing its competitive advantage and enabling it to expand its business throughout Canada. As the Bank grew and evolved, its name was rebranded to VersaBank, reflecting its versatility as a branchless financial institution and one able to quickly adapt to an ever-changing environment. In 2013, public investors were able to participate in the future success of VersaBank when it was listed on the TSX.

David Taylor's vision continues to be realized decades later as VersaBank develops and launches innovative, high value-add offerings to meet unmet demand, including a customized banking solution for insolvency professionals that integrates with that industry's most commonly used administrative software as well as a technology-based solution that provides inexpensive access to capital for point-of-sale loan and lease partners, allowing them, and their own retail customers to drive growth of their own businesses. In the words of our founder, "The model has evolved and changed to deal with market conditions over the years, but we're still providing innovative financial solutions to profitably address underserved segments of the Canadian banking market."

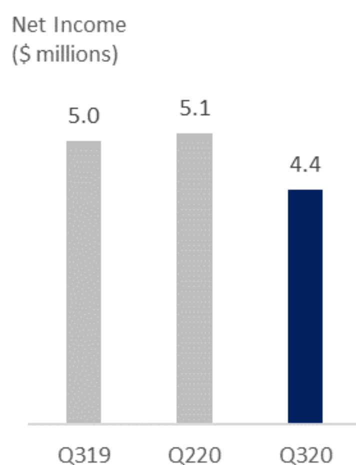
The Bank's results for the quarter ended July 31, 2020 continue to be affected by the deterioration of the Canadian economy precipitated by the COVID-19 pandemic ("COVID-19"). As we navigate through this challenging operating environment our focus has remained on the safety and wellness of our employees and clients as well as on the prudent mitigation of elevated credit and liquidity risks, enabled by our fully functional Work-From-Home solution which was a natural and seamless evolution of the Bank's branchless, technology-driven model.

Further, building on its efforts last quarter, the Bank continued to enhance as well as expand the depth and scope of its analysis supporting its assessment of impairment, or more specifically in the estimation of allowance for expected credit losses ("ECL"). In the estimation of its reported ECL for the current quarter, the Bank employed multiple, probability weighted forecast macroeconomic scenarios as well as asset-specific performance and market empirical trend data that was available as at July 31, 2020. The Bank's current ECL, although down modestly compared to last quarter, remains higher compared to pre-pandemic levels, or more specifically compared to ECL amounts reported in the first quarter of this year and a year ago as a function primarily of the changes to the forecast

macroeconomic scenario data used by the Bank as forward-looking information in its credit risk models. While the increase in ECL is driven by forward-looking information, the Bank has yet to realize losses associated with the onset of COVID-19. Forward-looking macroeconomic and industry data continues to change, specifically related to the economy's anticipated recovery trajectory. As a result, the Bank anticipates that estimated ECL amounts may continue to exhibit volatility in the coming quarters.

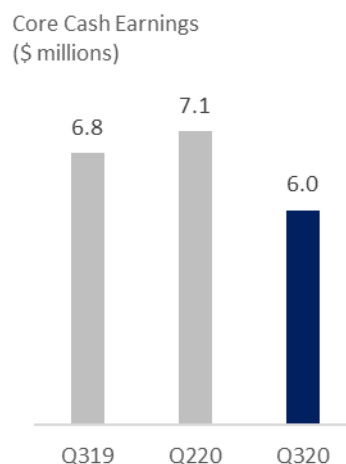
Despite the challenges associated with our current operating environment, the Bank remains focused on enhancing Core Cash Earnings performance by concentrating on niche markets that support modestly better pricing for its products, and by leveraging its diverse deposit gathering network which provides efficient access to a range of low-cost deposit sources, as well as by utilizing its technology advantage to not only gain access to these markets, but also to provide its customers with superior financial products and better customer service.

The underlying drivers of the Bank's performance trends for the current and comparative periods are set out in the following sections of this MD&A.



Net income for the quarter was $4.4 million or $0.18 per common share (basic and diluted), compared to $5.1 million or $0.22 per common share (basic and diluted) last quarter and $5.0 million or $0.21 per common share (basic and diluted) for the same period a year ago. The quarter over quarter trend was a function primarily of lower net interest income attributable to lower average earning assets, lower fees and higher liquidity costs, offset partially by lower provision for credit losses and lower non-interest expenses. The year over year trend was a function primarily of lower net interest income attributable to lower average earning assets and higher liquidity costs, offset partially by lower provision for credit losses and lower non-interest expenses.

Net income for the nine months ended July 31, 2020 was $14.7 million or $0.62 per common share (basic and diluted) compared to $14.8 million or $0.62 per common share (basic and diluted) for the same period a year ago. The year over year trend was a function primarily of higher provision for credit losses, attributable to higher ECL allowances resulting principally from the impact of the changes in the forward-looking information used by the Bank in its credit risk models in the current year, offset partially by higher net interest income and lower non-interest expenses.



Core cash earnings for the quarter were $6.0 million compared to $7.1 million last quarter and $6.8 million for the same period a year ago. The quarter over quarter and year over year trends were a function of the same combination of financial variable trends underlying the net income performance trends set out above.

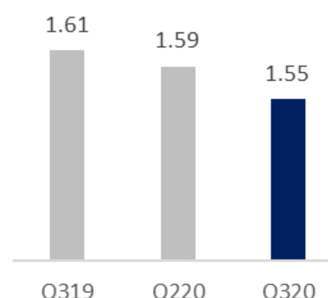
Core cash earnings for the nine months ended July 31, 2020 were $20.2 million compared to $20.4 million for the same period a year ago. The year over year trend was a function of the same combination of financial variable trends underlying the net income performance trends set out above.

Core cash earnings, which reflects the Bank's core operational performance and earnings capacity, is calculated as net income (as presented in the Consolidated Statements of Comprehensive Income) adjusted for income taxes, restructuring charges, corporate projects and other non-core operational expenses. The Bank did not pay cash taxes on its earnings in the current and comparative periods due to the utilization of available tax loss carryforwards. The following is the core cash earnings reconciliation.

(thousands of Canadian dollars)		
	for the three months ended	
	July 31 2020	July 31 2019
Net income	$ 4,369	$ 4,963
Adjusted for:		
Non-cash income taxes	1,657	1,874
Core cash earnings	$ 6,026	$ 6,837

(thousands of Canadian dollars)		
	for the nine months ended	
	July 31 2020	July 31 2019
Net income	$ 14,659	$ 14,791
Adjusted for:		
Non-cash income taxes	5,548	5,587
Core cash earnings	$ 20,207	$ 20,378

Total assets at July 31, 2020 were $1.93 billion compared to $1.97 billion last quarter and $1.78 billion a year ago. The quarter over quarter trend was a function primarily of lower lending assets offset partially by higher cash balances. The year over year trend was a function primarily of higher cash balances offset partially by lower lending assets as well as lower funds held for securitization liabilities attributable to repayments in the Bank's securitized mortgage portfolio.



Loans at July 31, 2020 were $1.55 billion compared to $1.59 billion last quarter and $1.61 billion a year ago. The quarter over quarter trend was a function primarily of lower origination activity combined with the negotiated, early repurchase of two portfolios of loan and lease receivables by one of the Bank's point of sale origination partners in the current quarter, offset partially by higher commercial real estate lending assets. The year over year trend was a function primarily of the negotiated, early repurchase of two portfolios of loan and lease receivables in the current quarter and the early repurchase of a portfolio of loan and lease receivables in the previous quarter by the Bank's point of sale origination partners as well as lower origination activity, offset partially by higher commercial real estate lending assets.

Gross impaired loans at July 31, 2020 were $6.7 million compared to $6.5 million last quarter and $25.5 million a year ago, or approximately 0.43% of total loans. The year over year trend was a function primarily of the repayment of a large real estate loan.

Total Revenue

Total revenue consists of net interest income and non-interest income. Non-interest income for the current quarter consisted primarily of income derived from miscellaneous transaction fees not directly attributable to lending assets. Non-

interest income is not currently a significant source of revenue for the Bank.

Total revenue for the quarter was $12.4 million compared to $14.5 million last quarter and $14.1 million for the same period a year ago. The quarter over quarter and year over year trends were a function primarily of lower income earned on lending assets and higher liquidity costs offset partially by lower interest expense.

Total revenue for the nine months ended July 31, 2020 was $40.5 million compared to $40.3 million for the same period a year ago. The year over year trend was a function primarily of lower interest expense offset partially by lower income earned on lending assets and higher liquidity costs.

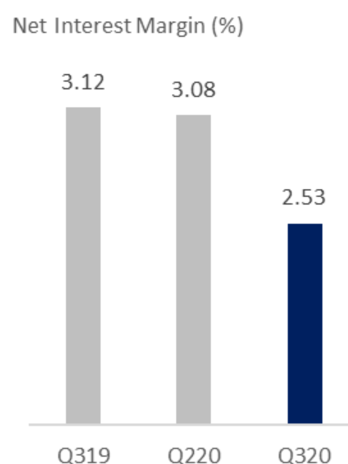
Net Interest Income

Net interest income for the quarter was $12.4 million compared to $14.5 million last quarter and $14.1 million for the same period a year ago. The quarter over quarter trend was a function primarily of lower interest income, attributable principally to lower average earning assets and higher liquidity costs resulting from the Bank holding higher, low-yielding cash balances as part of management's efforts to further strengthen the Bank's liquidity position in response to the impact of COVID-19 on the economy, and the Bank recognizing higher fees in the previous quarter resulting from the negotiated, early repurchase of a portfolio of loan and lease receivables by one of the Bank's point of sale origination partners, offset partially by lower interest expense.

The year over year trend was a function primarily of lower interest income, attributable principally to lower average earning assets and higher liquidity costs resulting from the Bank holding higher, low-yielding cash balances, offset partially by lower interest expense.

Net interest income for the nine months ended July 31, 2020 was $40.4 million compared to $40.2 million for the same period a year ago. The year over trend was a function primarily of the Bank recognizing fees associated with the negotiated, early repurchase of two portfolios of loan and lease receivables in the current quarter and the early repurchase of a portfolio of loan and lease receivables in the previous quarter by the Bank's point of sale origination partners combined with lower interest expense, offset partially by lower interest income earned on lending assets and higher liquidity costs resulting from the Bank holding higher, low-yielding cash balances over the course of the current and previous quarters of the current year.

Net Interest Margin



Net interest margin or spread for the quarter was 2.53% compared to 3.08% last quarter and 3.12% for the same period a year ago. The quarter over quarter and year over year trends were a function primarily of lower yields earned on lending assets and cash balances, offset partially by lower cost of funds and the Bank recognizing fees associated with the negotiated, early repurchase of two portfolios of loan and lease receivables in the current quarter.

Net interest margin or spread for the nine months ended July 31, 2020 was 2.91% compared to 3.00% for the same period a year ago. The year over year trend was a function primarily of lower yields earned on lending assets and cash balances, offset partially by lower cost of funds and the Bank recognizing fees associated with the negotiated, early repurchase of two portfolios

of loan and lease receivables in the current quarter and the early repurchase of a portfolio of loan and lease receivables in the previous quarter by the Bank's point of sale origination partners.

Provision for Credit Losses

Under IFRS 9 the Bank recognizes provision for credit losses on both performing loans, designated as stage 1 or stage 2 loans, and non-performing, or impaired loans, designated as stage 3 loans. Loans that have not experienced a significant increase in credit risk ("SICR") since initial recognition are designated as stage 1, while loans that have experienced a SICR since initial recognition are designated as stage 2, and loans that are determined to be credit impaired are designated as stage 3.

The IFRS 9 standard requires consideration of past events, current market conditions and reasonable, supportable information about future economic conditions, or forward-looking information in the estimation of ECL for loans and lending assets. The Bank incorporates the impact of future economic conditions, or more specifically forward-looking information into the estimation of ECL at the credit risk parameter level via its credit risk models that are used to develop probability of default ("PD") and loss given default ("LGD") term structure forecasts for its lending assets. The Bank utilizes macroeconomic indicator data derived from multiple macroeconomic forecast scenarios, those typically being baseline, upside, and downside scenarios in order to mitigate volatility in the estimation of ECL amounts 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. Moody's Analytics provides the macroeconomic forecast data that the Bank utilizes as forward-looking information in its credit risk models.

As a result of the deterioration of the Canadian economy resulting from the onset of COVID-19 over the course of the last quarter, the Bank utilizes a broader range of alternative macroeconomic scenarios as forward-looking information in its estimation and assessment of its ECL. The forecast macroeconomic scenarios utilized by the Bank in the current quarter benefit from updated data which provide additional insight into the magnitude of the initial impact of COVID-19 on Canada's economy, and as a result this quarter's forecast scenarios consistently present a level of deterioration that is measurably sharper and deeper than was anticipated by the previous quarter's forecast scenarios. At the same time, the duration of the recession is expected to be notably short as each of the forecast scenarios present a steep recovery over the course of the summer and into the late fall, with the magnitude of the recovery varying across each scenario.

Management anticipates that forward-looking macroeconomic and industry data will continue to change, specifically related to the economy's anticipated recovery trajectory and as a result expects that the Bank's estimated ECL amounts may continue to exhibit volatility in the coming quarters.

During the quarter, the Bank recorded a recovery of credit losses in the amount of $44,000 compared to a provision for credit losses in the amount of $490,000 last quarter and a provision for credit losses in the amount of $381,000 a year ago. The quarter over quarter trend was a function primarily of lower lending asset balances and net remeasurements of expected credit losses attributable to the impact of planned refinements to specific real estate asset loan and credit data inputs and changes to the forward-looking information used by the Bank in its credit risk models in the current quarter.

The year over year trend was a function primarily of net remeasurements of expected credit losses across substantially all of the Bank's lending asset categories attributable to the impact of the changes in the forward-looking information used by the Bank in its credit risk models in the current quarter, offset partially by lower lending asset balances.

For the nine months ended July 31, 2020, the Bank recognized a provision for credit losses in the amount of $238,000 compared to a recovery of credit losses in the amount $319,000 for the same period a year ago. The year over year trend was a function primarily of net remeasurements of expected credit losses across substantially all of the Bank's lending asset categories attributable to the impact of the changes in the forward-looking information used in the current year by the Bank in its credit risk models, offset partially by lower lending asset balances.

Non-Interest Expenses

Non-interest expenses of the Bank were $6.4 million compared to $6.9 million last quarter and $6.9 million for the same period a year ago. The quarter over quarter and year over year trends were a function primarily of the timing of certain budgeted expenses in the current quarter which resulted in lower general corporate expenses.

Non-interest expenses for the nine months ended July 31, 2020 were $20.0 million compared to $20.2 million a year ago. The year over year trend was a function primarily of the factors set out above.

Tax Provision

The statutory federal and provincial income tax rate of the Bank is approximately 27%, similar to that of previous periods. The statutory rate is impacted by certain items not being taxable or deductible for income tax purposes.

Provision for income taxes for the quarter was $1.7 million compared to $1.9 million for the previous quarter and $1.9 million for the same period a year ago.

Provision for income taxes for the nine months ended July 31, 2020 was $5.5 million compared to $5.6 million for the same period a year ago.

Comprehensive Income

Comprehensive income is comprised of net income for the period and other comprehensive income that consists of unrealized gains and losses on available-for-sale securities. Due to the current composition of the Bank's treasury portfolio, which consists primarily of cash, unrealized gains or losses in the portfolio are not significant and as a result comprehensive income does not differ significantly from net income.

Consolidated Balance Sheet

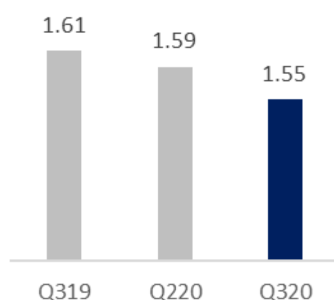
Total assets at July 31, 2020 were $1.93 billion compared to $1.97 billion last quarter and $1.78 billion a year ago. The quarter over quarter trend was a function primarily of lower lending asset balances, attributable to generally lower origination activity and the negotiated, early repurchase of two portfolios of loan and lease receivables by one of the Bank's origination partners in the current quarter, offset partially by higher cash balances. The year over year trend was a function primarily of higher cash balances attributable principally to management's efforts to further strengthen the Bank's liquidity position in response to the impact of COVID-19 on the economy, offset partially by lower lending asset balances, attributable to generally lower origination activity as well as the negotiated, early repurchase of two portfolios of loan and lease receivables in the current quarter and the early repurchase of a portfolio of loan and lease receivables in the previous quarter by the Bank's point of sale origination partners as well as lower funds held for securitization liabilities attributable to repayments in the Bank's securitized mortgage portfolio.

Cash and Securities

Cash and securities, which are held primarily for liquidity purposes, were $353.8 million or 18.3% of total assets at July 31, 2020 compared to $340.3 million or 17.3% of total assets last quarter and $118.3 million or 6.7% of total assets a year ago. The quarter over quarter and year over year trends were a function primarily of

management's continued efforts to strengthen its liquidity position as a prudent liquidity practice in these uncertain economic times combined with the timing of loan repayments and new fundings over the course of the respective periods.

Loans



The Bank organizes its lending portfolio into four asset categories, those being Commercial Real Estate, Non-Commercial Real Estate, Corporate and Public Sector Finance, and Structured Finance. These categories have been established in the Bank's proprietary, internally developed asset management system and have been designed to catalogue individual loans as a function primarily of their key risk drivers, the nature of the underlying collateral, and the applicable market segment.

The Commercial Real Estate ("CRE") asset category is comprised of commercial and residential construction loans, commercial term mortgages and land loans. While all of these loans would be considered commercial loans or business-to-business loans, the underlying credit risk exposure is diversified across both the commercial and retail market segments, and further, the portfolio benefits from diversity in its underlying security in the form of a broad range of collateral properties.

The Non-Commercial Real Estate ("Non-CRE") asset category is comprised primarily of Condominium Corporation Financing loans and Insured Mortgages, with the latter being substantially administered through the Bank's Canada mortgage bonds ("CMB") program.

The Corporate and Public Sector Finance asset category is comprised primarily of Public Sector Loans and Leases as well as a small balance of Corporate Loans and Leases. The Bank has pivoted away from corporate lending and is closely monitoring the public sector space in anticipation of more robust demand for Federal, Provincial and Municipal infrastructure and other project financings, partially in response to additional Government policy measures that may be established to support the recovery of the Canadian economy.

The Structured Finance asset category is comprised of point of sale loan and lease receivables acquired from the Bank's broad network of origination and servicing partners as well as warehouse loans that provide bridge financing to the Bank's origination and servicing partners for the purpose of amassing and seasoning practical volumes of individual loans and leases prior to the Bank purchasing the cashflow receivables derived from same.

Loans at July 31, 2020 were $1.55 billion compared to $1.59 billion last quarter and $1.61 billion a year ago. The quarter over quarter trend was a function primarily of generally lower origination activity in response to the deterioration of the Canadian economy resulting from COVID-19, combined with the negotiated, early repurchase of two portfolios of loan and lease receivables by one of the Bank's point of sale origination partners in the current quarter, offset partially by higher commercial real estate lending assets. The year over year trend was a function primarily of the negotiated, early repurchase of two portfolios of loan and lease receivables in the current quarter and the early repurchase of a portfolio of loan and lease receivables in the previous quarter by the Bank's point of sale origination partners, combined with generally lower origination activity in response to the deterioration of the Canadian economy in the

current year, offset partially by higher commercial real estate lending assets.

Residential mortgage exposures

In accordance with the Office of the Superintendent of Financial Institutions ("OSFI") *Guideline B-20 – Residential Mortgage Underwriting Practices and Procedures*, additional information is provided regarding the Bank's residential mortgage exposure. For the purposes of the Guideline, a residential mortgage is defined as a loan to an individual that is secured by residential property (one to four-unit dwellings) and includes home equity lines of credit (HELOC). This differs from the classification of residential mortgages used by the Bank which also includes multi-family residential mortgages.

Under OSFI's definition, the Bank's exposure to residential mortgages at July 31, 2020 was $4.1 million compared to $4.1 million last quarter and $307,000 a year ago. The Bank did not have any HELOC's outstanding at July 31, 2020, last quarter, or a year ago.

Credit Quality

As a result of the material deterioration in the Canadian economy precipitated by COVID-19, the Bank's credit risk department has taken a number of steps to increase the frequency and comprehensiveness of its review and assessment of the credit risk profile of the Bank's lending portfolio as well as in its monitoring of the general activity within each of the Bank's lending portfolios, including annual and interim reviews, risk rating adjustments, new credit volumes, funding requirements, requests for deferrals, concessions or restructurings and any risk rating adjustments precipitating from same, and further, has tightened its oversight of general adherence to the Bank's credit adjudication policies. In the current quarter, management continued to consider available information related to the number of active COVID-19 cases in Canada as well as the associated infection rate of the virus, the expected duration, scope and impact of active monetary and fiscal policy stimulus programs, and available market data in its interpretation of current and expected macroeconomic conditions and ultimately in its assessment of the credit risk profile of its lending portfolio. The rapid and material deterioration of the Canadian economy precipitated by the onset of COVID-19 has resulted in some clients experiencing challenges in their operating environments. The Bank continues to work closely with its clients in an effort to identify opportunities to mitigate the impact of the current economic environment on our clients' businesses and to provide working capital and liquidity solutions where possible, as well as to act as a potential intermediary with respect to available government relief programs. Some of our clients have requested deferrals on their loan payments ranging from three to four months in duration. The Bank is accruing and recognizing income on these deferred amounts, in line with the practice of the broader Canadian financial services industry. In addition, the Bank is working closely with its origination and servicing partners in its Structured Finance business line to ensure both Canadian consumer and commercial obligors of underlying loan and lease receivables receive deferral support as warranted due to COVID-19. As at July 31, 2020 our clients have requested deferrals on total loan balances equivalent to less than one percent of the Bank's total lending portfolio. At this time, management does not anticipate that the Bank will receive significant additional requests for deferrals over the coming quarters and as a result management does not believe that deferrals will have a material impact on the Bank's cash flows or volume of impaired loans.

Gross impaired loans at July 31, 2020, were $6.7 million, compared to $6.5 million last quarter and $25.5 million a year ago. The year over year trend was a function primarily of the repayment of a large real estate loan.

The IFRS 9 standard requires consideration of past events, current market conditions and reasonable, supportable information about future

economic conditions, or forward-looking information in the estimation of ECL for loans and lending assets. The Bank incorporates the impact of future economic conditions, or more specifically forward-looking information into the estimation of ECL at the credit risk parameter level via its credit risk models that are used to develop PD and LGD term structure forecasts for its lending assets. The Bank utilizes macroeconomic indicator data derived from multiple macroeconomic scenarios, those typically being baseline, upside, and downside scenarios in order to mitigate volatility in the estimation of ECL amounts 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. Moody's Analytics provides the macroeconomic forecast data that the Bank utilizes as forward-looking information in its credit risk models.

As a result of the onset of COVID-19, and the ensuing economic shock to the Canadian economy, management continues to consider a broader range of alternative macroeconomic scenarios in addition to the baseline, upside and downside scenarios referenced previously in the development of individual loan PD and LGD term structure forecasts for use in estimating the Bank's expected credit losses, and further, in its assessment of the adequacy of same. The forecast macroeconomic scenarios utilized by the Bank in the current quarter benefit from updated data which provide additional insight into the magnitude of the initial impact of COVID-19 on Canada's economy, and as a result this quarter's forecast scenarios consistently present a level of deterioration that is measurably sharper and deeper than was anticipated by the previous quarter's forecast scenarios. At the same time, the duration of the recession is expected to be notably short as each of the forecast scenarios present a steep recovery over the course of the summer and into the late fall, with the magnitude of the recovery varying across each scenario.

At July 31, 2020, the Bank's allowance for expected credit losses was $2.4 million compared to $2.4 million last quarter and $2.3 million a year ago, down 2% and up 1% over the respective periods. The quarter over quarter trend was a function primarily of lower lending asset balances and net remeasurements of expected credit losses attributable to the impact of planned refinements to specific real estate asset loan and credit data inputs and changes to the forward-looking information used by the Bank in its credit risk models in the current quarter. The year over year trend was a function primarily of the impact of net remeasurements of expected credit losses across substantially all of the Bank's lending asset categories attributable to the impact of the changes in the forward-looking information used by the Bank in its credit risk models in the current year, offset partially by lower lending asset balances.

Management anticipates that forward-looking macroeconomic and industry data will continue to change, specifically related to the economy's anticipated recovery trajectory and as a result, expects that the Bank's estimated ECL amounts will continue to exhibit some volatility in the coming quarters.

Considering the above, and based on management's review of the loan and credit data comprising its lending portfolio, combined with our interpretation of the available forecast macroeconomic and industry data, management is of the view that its estimated ECL allowance is a reasonable proxy for potential, future losses.

Other Assets

Other assets include working capital items, funds held for securitization liabilities, capital assets, right-of-use assets, and the deferred income tax asset. Other assets at July 31, 2020 were $28.7 million, compared to $31.1 million last quarter and $44.5 million a year ago. The quarter over quarter trend was a function primarily of draw downs on the deferred income tax asset derived from taxable income generated by the Bank and lower accounts receivable balances. The year over

year trend was a function primarily of lower funds held for securitization liabilities attributable to repayments in the Bank's securitized mortgage portfolio and accounts receivable combined with draw downs on the deferred income tax asset derived from taxable income generated by the Bank, offset partially by higher prepaid expenses and by the inclusion of right-of-use assets upon the adoption of IFRS 16 – *Leases* in the current year.

The deferred income tax asset was $6.7 million at July 31, 2020, compared to $8.2 million last quarter and $13.4 million a year ago. The quarter over quarter and year over year trends were a function primarily of draw downs on the deferred income tax asset related to taxable income generated by the Bank over the respective periods.

Deposits and Other Liabilities

The Bank has established three core funding channels, those being personal deposits, commercial deposits, and cash holdbacks retained from the Bank's receivable purchase program origination partners that are classified as other liabilities.

Personal deposits, consisting principally of guaranteed investment certificates, are sourced primarily through a well-established and well-diversified deposit broker network that the Bank continues to grow and expand across Canada. Personal deposits at July 31, 2020 were $1.1 billion compared to $1.1 billion last quarter and $976.6 million a year ago. The year over year trend was a function primarily of the Bank strengthening its liquidity position over the course of the current year as a prudent liquidity practice in response to the economic uncertainty resulting from the onset of COVID-19, offset partially by lower lending assets.

Commercial deposits are sourced primarily via specialized operating accounts made available to insolvency professionals ("Trustees") in the Canadian insolvency industry. The Bank developed customized banking software for use by Trustees that integrates banking services with the market-leading software platform used in the administration of consumer bankruptcy and proposal restructuring proceedings. Commercial deposits at July 31, 2020 were $486.5 million compared to $457.8 million last quarter and $421.7 million a year ago. The quarter over quarter and year over year trends were a function of continued growth in the number of Trustees that have established operating accounts with the Bank over the course of the respective periods.

Other liabilities at July 31, 2020 were $99.4 million compared to $112.4 million last quarter and $104.2 million a year ago. The quarter over quarter trend was a function primarily of lower holdbacks payable balances, attributable to lower loan and lease receivable balances. The year over year trend was a function primarily of lower holdbacks payable balances and lower cash collateral amounts held in escrow offset partially by the recognition of lease obligations in the amount of $3.3 million as a result of the Bank's adoption of IFRS 16 – *Leases* (see Change in Accounting Policies) during current the year.

Holdbacks payable balances at July 31, 2020 were $89.5 million compared to $101.3 million last quarter and $94.5 million a year ago. The quarter over quarter trend was a function primarily of lower loan and lease receivable balances attributable to the negotiated, early repurchase of two portfolios of loan and lease receivables by one of the Bank's origination partners in the current quarter, combined with generally lower origination activity. The year over year trend was a function of lower loan and lease receivable balances attributable to the negotiated, early repurchase of two portfolios of loan and lease receivables in the current quarter and the early repurchase of a portfolio of loan and lease receivables in the previous quarter by the Bank's point of sale origination partners, combined with generally lower origination activity.

Securitization Liabilities

Securitization liabilities relate to amounts payable to counterparties for cash received upon the

initiation of securitization transactions. Securitization liabilities at July 31, 2020 were $9.1 million compared to $9.0 million last quarter and $33.5 million a year ago. The year over year trend was a function primarily of the repayment of securitization liabilities during the current quarter. The remaining liability balances bear interest at a rate of 3.55% and mature in December 2020. Residential mortgages and other assets are pledged as collateral for securitized liabilities.

Subordinated Notes Payable

Subordinated notes payable, net of issue costs, were $4.9 million at July 31, 2020 compared to $4.9 million last quarter and $4.9 million a year ago. The subordinate notes are non-viability contingent capital ("NVCC") compliant with an effective interest rate of 10.41%.

Shareholders' Equity

Shareholders' equity was $251.6 million at July 31, 2020 compared to $248.3 million last quarter and $235.7 million a year ago. The quarter over quarter and year over year trends were a function primarily of retained earnings growth, offset partially by the payment of dividends.

Common shares outstanding at July 31, 2020 totalled 21,123,559, unchanged from last quarter and a year ago.

The Bank's book value per common share at July 31, 2020 was $10.52 compared to $10.37 last quarter and $9.77 a year ago with the increase being a function primarily of retained earnings growth, offset partially by the payment of dividends over the respective periods.

See Note 9 to the unaudited interim consolidated financial statements for additional information relating to share capital.

Updated Share Information

As at August 25, 2020, there were no changes since July 31, 2020 in the number of common shares, Series 1 and Series 3 preferred shares, and common share options outstanding.

Off-Balance Sheet Arrangements

As at July 31, 2020, the Bank did not have any significant off-balance sheet arrangements other than loan commitments and letters of credit resulting from normal course business activities. See Note 12 to the unaudited interim consolidated financial statements for more information.

Related Party Transactions

The Bank's Board of Directors and senior executive officers represent key management personnel. At July 31, 2020, amounts due from these related parties totalled $3.8 million compared to $4.6 million last quarter and $1.4 million a year ago. The quarter over quarter trend was a function of loan repayments made in the current quarter. The year over year trend was a function primarily of new loans and advances made to key management personnel in the current fiscal period which are secured by real property and securities. Interest income earned on the above loans for the three months and nine months ended July 31, 2020 was $17,000 (July 31, 2019 - $13,000) and $45,000 (July 31, 2019 - $34,000) respectively. The interest rates charged on loans and advances made to related parties are typically similar to those charged in an arms-length transaction. All loans issued to key management personnel were current as at July 31, 2020 and 2019.

Risk Management

Risk management involves the identification, ongoing assessment, managing and monitoring of material risks that could adversely affect the Bank. Due to the nature of the Bank's business, the Bank is inherently exposed to credit risk, liquidity risk, and market risks.

The Bank's risk management policies and procedures are set out in its annual MD&A for the year ended October 31, 2019. Notwithstanding

the above, again this quarter management elected to include expanded disclosure in the key risk sections below, relative to the content typically included in the Bank's quarterly MD&A related to the Bank's practices and activities associated with the management of its key risk exposures, which have been strengthened in response to the significant deterioration in the Canadian economy as a result of the onset of COVID-19.

Credit Risk

Credit risk is the risk of loss associated with a borrower, guarantor, or counterparty's inability or unwillingness to fulfill its contractual obligations. The Bank is exposed to credit risk primarily as a result of its lending activities but also as a result of investing in securities. As a result of the material deterioration in the Canadian economy precipitated by COVID-19, the Bank's credit risk department has taken a number of steps to increase the frequency and comprehensiveness of its review and assessment of the credit risk profile of the Bank's lending portfolio as well as in its monitoring of the general activity within each of the Bank's lending portfolios, including annual and interim reviews, risk rating adjustments, new credit volumes, funding requirements, requests for deferrals, concessions or restructurings and any risk rating adjustments precipitating from same, and further, has tightened its oversight of general adherence to the Bank's credit adjudication policies. In the current quarter management continued to consider available information related to the number of active COVID-19 cases in Canada as well as the associated infection rate of the virus, the expected duration, scope and impact of active monetary and fiscal policy stimulus programs, and available market data in its interpretation of current and expected macroeconomic conditions and ultimately in its assessment of the credit risk profile of the Bank's lending portfolio.

The Bank manages its lending activity credit risk using policies that have been recommended by the Chief Credit Officer and the Chief Risk Officer to the Risk Oversight Committee, which then recommends the policies to the Board of Directors for approval. These policies consist of approval procedures and limits on loan amounts, portfolio concentration, geographic concentration, industry concentration, asset category, loans to any one entity and associated groups, a risk rating policy that assigns a risk rating to each asset in its lending portfolio, and early recognition of problem accounts with an action plan for each account. The Risk Oversight Committee reviews these policies on an ongoing basis.

The Bank manages credit risk associated with securities included in its Treasury portfolio by applying policies that have been recommended by the Chief Credit Officer and the Chief Risk Officer to the Risk Oversight Committee, which then recommends the policies to the Board of Directors for approval. These policies consist of approval procedures and restrictions in the selection of security dealers, restrictions in the nature of securities selected, and in setting securities portfolio concentration limits. The Risk Oversight Committee reviews these policies on an ongoing basis.

The Risk Oversight Committee, comprised entirely of independent directors, performs the following functions related to credit risk:

- Recommends policies governing management of credit risks to the Board of Directors for approval and reviews credit risk policies on an ongoing basis to ensure that they are prudent and appropriate given possible changes in market conditions and corporate strategy;

- Concurs with credits exceeding the levels delegated to management, prior to commitment;

- Reviews, on a regular basis, watchlist accounts, impaired loans and accounts that have gone into arrears and expected credit loss analysis on a quarterly basis.

Liquidity Risk

Liquidity risk is the risk that the Bank is unable to meet the demand for cash to fund obligations as they come due. The Bank is exposed to liquidity risk as a result of timing differences in the cash flows of its lending activities, security investment activities and deposit taking activities. The Bank has established policies to ensure that its cash outflows and inflows are closely matched and that its sources of deposits are diversified between funding sources and over a wide geographic area. In the current quarter management considered the general activity and trends in its key deposit markets, the expected duration, scope and impact of active monetary and fiscal policy stimulus programs and the anticipated impact of same on its future cashflow requirements in its assessment of its liquidity risk profile. In the current quarter the Bank continued to maintain elevated liquidity levels as a prudent liquidity practice in response to the persisting economic uncertainty resulting from the impact of COVID-19.

The Risk Oversight Committee recommends policies governing management of liquidity risk to the Board for approval and reviews liquidity policies on an ongoing basis. It receives and reviews quarterly securities portfolio reports and liquidity risk reports from management relating to its liquidity position. Additionally, an Asset Liability Committee, consisting of members of senior management, monitors liquidity risk, reviews compliance with policies and discusses strategies in this area.

Market Risk

Market risk is the risk of a negative impact on the balance sheet and/or income statement resulting from changes or volatility in market factors such as interest rates or market prices. The Bank's principal market risk arises from interest rate risk as the Bank does not undertake any material foreign exchange or trading activities. The Risk Oversight Committee is charged with recommending policies that govern market risk to its Board of Directors for approval and with reviewing the policies on an ongoing basis.

Interest rate risk is the risk that a movement in interest rates could negatively impact spread, net interest income and the economic value of assets, liabilities and shareholders' equity. The Bank manages interest rate risk by employing a number of methods including income simulation analysis and interest rate sensitivity gap and duration analysis.

Management prepares regular reports to the Board to allow for ongoing monitoring of the Bank's interest rate risk position. The Asset Liability Committee reviews the results of these analyses on a monthly basis and monitors compliance with limits set by corporate policy.

The management of interest rate risk also includes stress testing the Bank's financial assets and liabilities to various standard and non-standard interest rate scenarios.

Capital Management and Capital Resources

The Basel Committee on Banking Supervision has rules on capital adequacy and liquidity ("Basel III"). Significant rules under Basel III that are most relevant to the Bank include:

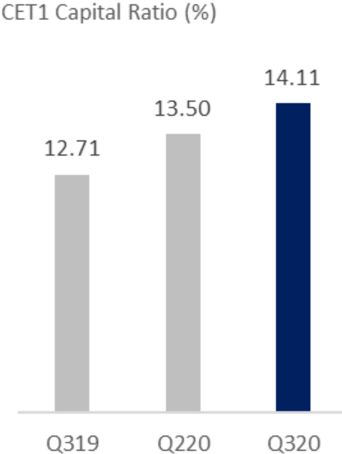
- Increased focus on tangible common equity;
- All forms of non-common equity and debt must be NVCC compliant. NVCC compliant means that the instrument must include a clause that would require conversion to common equity in the event that OSFI deems the institution to be insolvent or a government is planning to inject a "bail out" payment;
- Changes in the risk-weighting of certain assets;
- Additional capital buffers;
- Requirements for levels of liquidity and new liquidity measurements.

The Bank reports its regulatory capital ratios using the Standardized approach for calculating risk-weighted assets, as defined under Basel III, which may require the Bank to carry more capital for certain credit exposures compared to requirements under the Advanced Internal Ratings Based ("AIRB") methodology. As a result, regulatory capital ratios of banks that utilize the Standardized approach are not directly comparable with the large Canadian banks that employ the AIRB methodology.

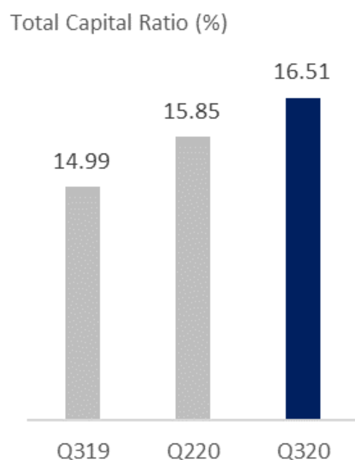
OSFI requires that all Canadian banks must comply with the Basel III standards on an "all-in" basis for purposes of determining its risk-based capital ratios. Required minimum regulatory capital ratios are a 7.0% Common Equity Tier 1 ("CET1") capital ratio, an 8.5% Tier 1 capital ratio and a 10.5% total capital ratio, all of which include a 2.5% capital conservation buffer.

As the Bank makes use of the Standardized Approach for credit risk as prescribed by OSFI, it may include eligible ECL allowance amounts in its Tier 2 capital, up to a maximum of 1.25% of its credit risk-weighted assets calculated under the Standardized Approach. Further to this, and as a result of the onset of COVID-19 and the economic uncertainty associated with same, OSFI introduced guidance over the course of the previous quarter that set out transitional arrangements pertaining to the capital treatment of expected loss provisioning which allows for a portion of eligible ECL allowances to be included in CET1 capital on a transitional basis over the course of the period ranging between 2020 and 2022 inclusive. The portion of ECL allowances that is eligible for inclusion in CET1 capital is calculated as the increase in the sum of Stage 1 and Stage 2 ECL allowances estimated in the current quarter relative to the sum of Stage 1 and Stage 2 ECL allowances estimated for the baseline period, which has been designated by OSFI to be the three months ended January 31, 2020, adjusted for tax effects and multiplied by a scaling factor. The scaling factor has been set by OSFI at 70% for fiscal 2020, 50% for fiscal 2021 and 25% for fiscal 2022. The impact of the capital treatment of expected loss provisioning on the Bank's capital levels and associated capital ratios is presented in Note 15 to the Bank's July 31, 2020 interim Consolidated Financial Statements.

Under the Basel III standards, total regulatory capital of the Bank was $250.7 million at July 31, 2020 compared to $246.0 million last quarter and $225.6 million a year ago. The quarter over quarter and year over year trends were a function primarily of retained earnings growth and tax provision recoveries related to the Bank's deferred tax asset, combined with the inclusion of eligible ECL allowance amounts in the current and prior quarters.



The Bank's CET1 capital ratio was 14.11% at July 31, 2020 compared to 13.50% last quarter and 12.71% a year ago. The quarter over quarter trend was a function of retained earnings growth, tax provision recoveries related to the Bank's deferred tax asset, and lower risk-weighted assets. The year over year trend was a function of retained earnings growth, tax provision recoveries related to the Bank's deferred tax asset, and the inclusion of eligible ECL allowance amounts related to the transitional arrangements pertaining to the capital treatment of expected loss provisioning as set out by OSFI, offset partially by higher risk-weighted assets.



The Bank's total capital ratio at July 31, 2020 was 16.51% compared to 15.85% last quarter and 14.99% a year ago. The quarter over quarter trend was a function of retained earnings growth, tax provision recoveries related to the Bank's deferred tax asset, and lower risk-weighted assets. The year over year trend was a function of retained earnings growth, tax provision recoveries related to the Bank's deferred tax asset, and the inclusion of eligible ECL allowance amounts in Tier 2 capital, offset partially by higher risk-weighted assets.

The Bank's leverage ratio at July 31, 2020 was 11.99% compared to 11.48% last quarter and 11.90% a year ago, nearly four times the Basel III minimum leverage ratio of 3.0%.

See Note 15 to the Bank's July 31, 2020 interim Consolidated Financial Statements for more information regarding capital management.

Liquidity

The unaudited Consolidated Statement of Cash Flows for the nine months ended July 31, 2020 shows cash provided by operations of $234.2 million compared to cash used by operations of $12.4 million for the same period last year. The net increase in cash from operations was a function primarily of inflows from deposits raised as the Bank strengthened its liquidity position as a prudent liquidity practice in response to the economic uncertainty resulting from the onset of COVID-19, increased loan repayments and a reduction in restricted cash balances used to offset the payment of the maturing securitization liabilities. The net use of cash by operations for the comparative period was a function primarily of deposit maturities exceeding loan repayments.

Based on factors such as liquidity requirements and opportunities for investment in loans and securities, the Bank may manage the amount of deposits it raises and loans it funds in ways that result in the balances of these items giving rise to either negative or positive cash flow from operations. The Bank will continue to fund its operations and meet contractual obligations as they become due using cash on hand and by closely managing its flow of deposits.

Interest Rate Risk Management

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 table below presents 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. The Bank's sensitivity to changes in interest rates is presented in the table below. At July 31, 2020, the impact on net interest income during a 12 month period of a 100 basis point increase in rates would be approximately $3.2 million, while the impact on net interest income of a 100 basis point decrease in rates would be approximately ($1.9 million). Further, at July 31, 2020, the impact on equity during a 60 month period of a 100 basis point increase in rates would be approximately ($1.8 million), while the impact on equity of a 100 basis point decrease in rates would be approximately $1.3 million. At July 31, 2020, the duration difference between assets and liabilities was 0.4 months compared to 1.3 months at October 31, 2019, which indicates that the Bank's assets and liabilities would reprice at

approximately the same time in the event of a future change in interest rates.

(thousands of Canadian dollars)	July 31, 2020	
	Increase 100 bps	Decrease 100 bps
Increase (decrease):		
Impact on projected net interest income during a 12 month period	$ 3,178	$ (1,851)
Impact on reported equity during a 60 month period	$ (1,764)	$ 1,253
Duration difference between assets and liabilities (months)	0.4	

(thousands of Canadian dollars)	October 31, 2019	
	Increase 100 bps	Decrease 100 bps
Increase (decrease):		
Impact on projected net interest income during a 12 month period	$ 1,621	$ (1,613)
Impact on reported equity during a 60 month period	$ (3,669)	$ 3,780
Duration difference between assets and liabilities (months)	1.3	

Capital Assets

The Bank's operations are not dependent upon significant amounts of capital assets to generate revenue. Currently, the Bank does not have any material commitments for capital expenditures or for significant additions to its level of capital assets.

As a result of the adoption of IFRS 16 – Leases, the Bank has recognized leases that were previously classified as operating leases and not reflected on the Bank's balance sheet. As at November 1, 2019 the Bank recognized right-of-use capital assets in the amount of $3.3 million related to leases associated with the Bank's operating facilities. See Changes in Accounting Policies below.

Contractual Obligations

Contractual obligations as disclosed in the Bank's MD&A and Audited Consolidated Financial Statements for the year ended October 31, 2019, have not changed significantly as at July 31, 2020.

Summary of Quarterly Results

(thousands of Canadian dollars except per share amounts)	2020			2019				2018
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4
Results of operations:								
Interest income	$ 20,172	$ 22,688	$ 22,166	$ 22,263	$ 22,958	$ 21,125	$ 21,959	$ 22,036
Yield on assets (%)	4.12%	4.83%	4.84%	4.96%	5.10%	4.89%	4.90%	4.82%
Interest expense	7,788	8,212	8,609	8,608	8,899	8,382	8,519	8,329
Cost of funds (%)	1.59%	1.75%	1.88%	1.92%	1.98%	1.94%	1.90%	1.82%
Net interest income	12,384	14,476	13,557	13,655	14,059	12,743	13,440	13,707
Net interest margin (%)	2.53%	3.08%	2.96%	3.04%	3.12%	2.95%	3.00%	3.00%
Total revenue	12,392	14,485	13,582	13,635	14,078	12,747	13,459	13,827
Provision for (recovery of) credit losses	(44)	490	(208)	21	381	(411)	(289)	191
Non-interest expenses	6,410	6,899	6,705	6,171	6,860	6,411	6,954	6,423
Efficiency ratio	52%	48%	49%	45%	49%	50%	52%	46%
Core cash earnings	6,026	7,096	7,085	7,443	6,837	6,747	6,794	7,108
Core cash earnings per common share	$ 0.29	$ 0.34	$ 0.34	$ 0.36	$ 0.32	$ 0.32	$ 0.32	$ 0.33
Income before income taxes	6,026	7,096	7,085	7,443	6,837	6,747	6,794	7,213
Tax provision	1,657	1,947	1,944	2,038	1,874	1,851	1,862	2,049
Net income	$ 4,369	$ 5,149	$ 5,141	$ 5,405	$ 4,963	$ 4,896	$ 4,932	$ 5,164
Income per share								
Basic	$ 0.18	$ 0.22	$ 0.22	$ 0.23	$ 0.21	$ 0.21	$ 0.21	$ 0.21
Diluted	$ 0.18	$ 0.22	$ 0.22	$ 0.23	$ 0.21	$ 0.21	$ 0.21	$ 0.21
Return on average common equity	6.90%	8.64%	8.60%	9.23%	8.56%	8.89%	8.86%	9.53%
Core cash return on average common equity	9.89%	12.29%	12.23%	13.11%	12.20%	12.68%	12.62%	13.55%
Return on average total assets	0.78%	0.98%	1.01%	1.08%	0.98%	1.01%	0.98%	1.01%
Gross impaired loans to total loans	0.43%	0.41%	0.38%	0.39%	1.58%	1.57%	1.22%	0.04%

The financial results for each of the last eight quarters are summarized above. Key drivers of the quarter over quarter performance trends for the current reporting period were: lower interest income attributable to lower average earning assets, the Bank recognizing higher fees in the previous quarter resulting from the negotiated, early repurchase of a portfolio of loan and lease receivables by one of the Bank's point of sale origination partners, higher liquidity costs

attributable to the Bank strengthening its liquidity position over the course of the past two quarters, and continued, lower interest expense.

Basis of Presentation

Non-GAAP and Additional GAAP Measures

Core Cash Earnings

Core cash earnings, which reflects the Bank's core operational performance and earnings capacity, is calculated as net income (as presented in the Consolidated Statements of Comprehensive Income) adjusted for income taxes, restructuring charges, corporate projects and other non-core operational expenses. Core cash earnings does not have a standardized meaning prescribed by IFRS and, therefore, may not be comparable to similar measures presented by other financial institutions.

Core Cash Earnings per Common Share

Core cash earnings per common share is defined as core cash earnings divided by the number of common shares outstanding.

Yield

Yield is calculated as interest income (as presented in the Consolidated Statements of Comprehensive Income) divided by average total assets. Yield does not have a standardized meaning prescribed by IFRS and, therefore, may not be comparable to similar measures presented by other financial institutions.

Cost of Funds

Cost of funds is calculated as interest expense (as presented in the Consolidated Statements of Comprehensive Income) divided by average total assets. Cost of funds does not have a standardized meaning prescribed by IFRS and, therefore, may not be comparable to similar measures presented by other financial institutions.

Net Interest Income and Net Interest Margin or Spread

Most banks analyze profitability by net interest income (as presented in the Consolidated Statements of Comprehensive Income) and net interest margin or spread. Net interest margin or spread is calculated as net interest income divided by average total assets. Net interest margin or spread does not have a standardized meaning prescribed by IFRS and, therefore, may not be comparable to similar measures presented by other financial institutions.

Return on Average Common Equity

Return on average common equity is defined as annualized net income less amounts relating to preferred share dividends, divided by average common shareholders' equity which is average shareholders' equity less amounts relating to preferred shares recorded in equity.

Core Cash Return on Average Common Equity

Core cash return on average common equity is defined as annualized core cash earnings less amounts relating to preferred share dividends, divided by average common shareholders' equity which is average shareholders' equity less amounts relating to preferred shares recorded in equity.

Book Value per Common Share

Book value per common share is defined as Shareholders' Equity less amounts relating to preferred shares recorded in equity, divided by the number of common shares outstanding.

Efficiency Ratio

The efficiency ratio is calculated as non-interest expenses as a percentage of total revenue (as presented in the interim Consolidated Statements of Comprehensive Income). This ratio does not have a standardized meaning prescribed by IFRS and, therefore, may not be comparable to similar

measures presented by other financial institutions.

Return on Average Total Assets

Return on average total assets is defined as annualized net income less amounts relating to preferred share dividends, divided by average total assets.

Gross Impaired Loans to Total Loans

The measure captures gross impaired loan balances as a percentage of the Bank's loans, net of allowance for credit losses. This percentage does not have a standardized meaning prescribed by IFRS and, therefore, may not be comparable to similar measures presented by other financial institutions.

Provision for (Recovery of) Credit Losses as a Percentage of Average Total Loans

This measure captures the provision for (recovery of) credit losses (as presented in the interim Consolidated Statements of Comprehensive Income) as a percentage of the Bank's average loans, net of allowance for credit losses. This percentage does not have a standardized meaning prescribed by IFRS and, therefore, may not be comparable to similar measures presented by other financial institutions.

Basel III Common Equity Tier 1, Tier 1, Total Capital Adequacy and Leverage Ratios

Basel III Common Equity Tier 1, Tier 1, total capital adequacy and leverage ratios are determined in accordance with guidelines issued by the Office of the Superintendent of Financial Institutions (*Canada*) (OSFI).

Significant Accounting Policies and Use of Estimates and Judgments

Significant accounting policies are detailed in Note 3 of the Bank's 2019 Audited Consolidated Financial Statements. There have been no material changes in accounting policies since October 31, 2019, except for changes to accounting policies resulting from the adoption of IFRS 16 – *Leases* noted in Changes in Accounting Policies below.

In preparing the 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 periods. Areas where significant judgement was exercised include the business model applied for the classification and measurement of financial instruments, assessing significant changes in credit risk on financial assets and in the selection of relevant forward-looking information in assessing the Bank's allowance for credit losses on its loans, as described below in Allowance for Expected Credit Losses.

Estimates were developed in the calculation of the Bank's expected credit loss allowance and in the measurement of deferred income taxes. It is reasonably possible, on the basis of existing knowledge, that actual results may vary from the amounts calculated using these estimated amounts. This could result in material adjustments to the carrying amounts of assets and/or liabilities affected in the future.

The impact of COVID-19 continues to introduce measurable uncertainty and volatility into available forward-looking information, including forecast macroeconomic and industry performance trend data, which in turn has introduced uncertainty into the assumptions and judgements made by management in the preparation of the interim Consolidated Financial Statements, including, but not limited to the impact of COVID-19 on the Canadian economy, the effectiveness of the mitigating policy measures introduced by the Government and the Bank of Canada, and the impact that each of these may have on the Bank's business, operations and financial performance. As a result, the estimates developed by management, that are included in the Bank's interim Consolidated

Financial Statements are subject to a higher level of uncertainty.

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

The policies discussed below are considered particularly significant as they require management to make estimates or judgements, some of which may relate to matters that are inherently uncertain.

Loans

Loans are classified at initial recognition based on the contractual cash flow characteristics and the business model under which the loan is managed. Loans are classified and measured at amortized cost, fair value through other comprehensive income or fair value through profit and loss.

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. Under IFRS 9 the Bank's allowance for expected credit losses is estimated using the ECL methodology and is comprised of expected credit losses recognized on both performing loans, and non-performing, or impaired loans even if no actual loss event has occurred.

For performing loans, the allowance for expected credit losses is an estimate of the 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: PD, EAD, and LGD associated with each loan, sensitized to future market and macroeconomic conditions through the incorporation of forward-looking information derived from multiple economic forecast scenarios (see Forward-Looking Information below).

Individual allowances are estimated for non-performing loans that are determined to be credit impaired. A loan or financial instrument is classified as credit impaired when the Bank becomes aware that all, 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.

Assessment of significant increase in credit risk ("SICR")

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.

Again this quarter management considered the Bank's SICR methodology in the context of the material deterioration in macroeconomic conditions precipitated by COVID-19 with specific focus on the potential impact of deferrals, concessions or restructuring of principal and interest payments and has determined that such arrangements on their own do not qualify as a SICR. Further, management concluded that the determination of a SICR remains a function of the loan's internal risk rating assignment, internal watchlist status, and delinquency status which are updated as necessary in response to changes including, but not limited to changes in macroeconomic and/or market conditions, changes in a borrower's credit risk profile, and changes in the strength of the underlying security, including guarantor status, if a guarantor exists.

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 considered to supplement such a gap. Examples include changes in adjudication criteria for a particular

group of borrowers or asset categories or changes in portfolio composition, and more specifically for the current quarter, changes attributable to the continued impact of COVID-19 on the Canadian economy.

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: PD, LGD, and EAD associated with each loan, sensitized to future market and macroeconomic conditions through the incorporation of forward-looking information derived from multiple economic forecast scenarios, typically including baseline, upside, and downside scenarios. Management reviewed its ECL model in the context of the material deterioration in macroeconomic conditions precipitated by COVID-19 and the impact of same on the forward-looking information applied to the model, and concluded that both the model, and the associated methodology were generally capable of effectively interpreting and incorporating an economic shock of this nature, as well as the residual effects of same into the estimation of expected credit losses on the Bank's lending portfolio.

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 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 incorporates 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 macroeconomic scenario data from Moody's Analytics for the purpose of computing forward-looking credit risk parameters under multiple macroeconomic 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 typically utilizes macroeconomic indicator data derived from multiple macroeconomic scenarios, those typically being baseline, upside, and downside scenarios 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 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. As a result of the onset of COVID-19, and the ensuing economic shock to the Canadian economy management continues to consider a broader range of alternative forecast macroeconomic scenarios in addition to the baseline, upside and downside scenarios referenced previously in the development of individual loan PD and LGD term structure forecasts for use in estimating the Bank's expected credit losses, and further, in its assessment of the adequacy of same.

The macroeconomic indicator data utilized by the Bank for the purpose of sensitizing PD and LGD 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 small and medium-sized enterprise ("SME") borrower performance; geography; as well as collateral value trajectories, are appropriately captured and incorporated into the Bank's forward macroeconomic sensitivity analysis.

The forecast macroeconomic scenarios utilized by the Bank in the current quarter benefit from updated data which provide additional insight into the magnitude of the initial impact of COVID-19 on Canada's economy, and as a result this quarter's forecast scenarios consistently present a level of deterioration that is measurably sharper and deeper than was anticipated by the previous quarter's forecast scenarios. At the same time, the duration of the recession is notably short as each of the forecast scenarios present a steep recovery over the course of the summer and into the late fall, with the magnitude of the recovery varying across each scenario. The baseline forecast scenario contemplates the Canadian economy recovering reasonably quickly and peaking late in the third quarter (calendar) t, at which point the recovery moderates, and the economy eventually modestly contracts over the course of the fourth quarter (calendar) and into the first half of 2021 before returning to more sustained, normalized levels over the course of the latter half of calendar 2021. While the upside and downside scenarios present somewhat similar economic profiles to that of the baseline scenario set out above, the downside scenario presents measurably lower, initial recovery levels and more pronounced and prolonged economic contraction over the course of the fourth quarter (calendar) and into and through 2021, while the upside scenario anticipates a more robust, initial recovery with a much more modest contraction over the second half of calendar 2020 and into calendar 2021, with the economy achieving more normalized levels over the course of the third quarter (calendar) 2021.

Key assumptions driving each of the macroeconomic scenarios utilized by the Bank include, but are not limited to; the number of businesses that are able to reopen and operate as the provinces continue to advance their re-opening plans, anticipated consumer spending levels, expectations for the realization, (or not) of a second wave of COVID-19, the volume of confirmed COVID-19 cases and the rate of new infections, the impact of elevated unemployment levels on loan defaults, the expiry or potential extension of federal government stimulus programs, and the Bank of Canada's position on monetary policy, specifically related to the commitment to keep the overnight rate fixed at 0.25% into 2023.

Management remains of the view that forward-looking macroeconomic and industry data will continue to change as the provinces continue to re-open their economies, as more information becomes available related to understanding the correlation, if any, between loan deferrals granted by banks and future loan defaults, as the potential duration and scope of federal government and Bank of Canada stimulus programs are clarified,

and a better understanding of the epidemiological trajectory of COVID-19 is accomplished. As a result, the Bank expects that its estimated ECL amounts may continue to exhibit some volatility in the coming quarters.

Corporate Income Taxes

Current income taxes are calculated based on taxable income at the reporting period end. Taxable income differs from accounting income because of differences in the inclusion and deductibility of certain components of income which are established by Canadian taxation authorities. Current income taxes are measured at the amount expected to be recovered or paid using statutory tax rates at the reporting period end.

The Bank follows the asset and liability method of accounting for deferred income taxes. Deferred income tax assets and liabilities arise from temporary differences between financial statement carrying values and the respective tax base of those assets and liabilities. Deferred income tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years when temporary differences are expected to be recovered or settled.

Deferred income tax assets are recognized in the consolidated financial statements to the extent that it is probable that the Bank will have sufficient taxable income to enable the benefit of the deferred income tax asset to be realized. Unrecognized deferred income tax assets are reassessed for recoverability at each reporting period end.

The realization of the deferred income tax asset is dependent upon the Bank being able to generate taxable income during the carry-forward period sufficient to offset the income tax losses and deductible temporary timing differences. While management is of the opinion that it is probable that the Bank will be able to realize the deferred income tax asset, there is no guarantee that the Bank will be able to generate sufficient taxable income during the carry-forward period. The realization of the deferred income tax asset is dependent upon the Bank being able to generate taxable income in future years sufficient to offset the income tax losses.

Changes in Accounting Policies

Leases (IFRS 16)

Effective November 1, 2019, the Bank adopted IFRS 16, which sets out prescribed methodology related to the recognition, measurement, presentation and disclosure of operational leases. The standard provides a single lessee accounting model, requiring lessees to recognize assets and liabilities for all major leases. IFRS 16 supersedes previous accounting standards for leases, including IAS 17, Leases and IFRIC 4 – Determining whether an arrangement contains a lease. As a result of adopting IFRS 16, the Bank recognized an increase to both assets and liabilities on the Consolidated Balance Sheet, as well as a decrease in rent expense, with a corresponding increase in amortization expense (due to depreciation of the right-of-use assets) and an increase in finance costs (due to accretion of the lease obligations).

Prior to the adoption of IFRS 16 the Bank's total minimum operating lease commitments as at October 31, 2019 were $6.8 million. On initial application, the Bank has elected to record right-of-use assets based on the corresponding lease obligation. Right-of-use assets and lease obligations of $3.3 million were recorded as of November 1, 2019, with no net impact on retained earnings. When measuring its lease liabilities, the Bank discounted its lease payments at its incremental borrowing rate, applicable to the asset class(es) at November 1, 2019. The weighted-average rate applied is 4.4%.

Additional information on the Bank's adoption of IFRS 16 is reflected in note 3 of the Bank's July 31, 2020 interim Consolidated Financial Statements.

Future Changes in Accounting Policies

The Bank monitors the potential changes proposed by the IASB and assesses the impact that change in accounting standards may have on the Bank's financial reporting and accounting policies. Future accounting policies that may impact the Bank can be found on page 21 of the Bank's 2019 annual MD&A and note 4 of the Bank's 2019 annual consolidated financial statements.

Controls and Procedures

During the quarter ended July 31, 2020, there were no changes in the Bank's internal controls over financial reporting, that have materially affected, or are reasonably likely to materially affect, the Bank's internal controls over financial reporting.

Forward-Looking Statements

The statements in this management's discussion and analysis that relate to the future are forward-looking statements. By their very nature, forward-looking statements involve inherent risks and uncertainties, both general and specific, many of which are out of the Bank's control. Risks exist that predictions, forecasts, projections and other forward-looking statements will not be achieved. Readers are cautioned not to place undue reliance on these forward-looking statements as a number of important factors could cause actual results to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements. These factors include, but are not limited to, the strength of the Canadian economy in general and the strength of the local economies within Canada in which the Bank conducts operations; the effects of changes in monetary and fiscal policy, including changes in interest rate policies of the Bank of Canada; global commodity prices; the effects of competition in the markets in which the Bank operates; inflation; capital market fluctuations; the timely development and introduction of new products in receptive markets; the impact of changes in the laws and regulations regulating financial services; changes in tax laws; technological changes; unexpected judicial or regulatory proceedings; unexpected changes in consumer spending and savings habits; the impact of COVID-19 and the Bank's anticipation of and success in managing the risks implicated by the foregoing. For a detailed discussion of certain key factors that may affect our future results, please see our annual MD&A for the year ended October 31, 2019.

The foregoing list of important factors is not exhaustive. When relying on forward-looking statements to make decisions, investors and others should carefully consider the foregoing factors and other uncertainties and potential events. The forward-looking information contained in the management's discussion and analysis is presented to assist our shareholders in understanding our financial position and may not be appropriate for any other purposes. Except as required by securities law, we do not undertake to update any forward-looking statement that is contained in this management's discussion and analysis or made from time to time by the Bank or on its behalf.

FOR FURTHER INFORMATION PLEASE CONTACT:

Investor Relations: Wade MacBain (800) 244-1509, wadem@versabank.com
Visit our website at: www.versabank.com