EXCHANGE BANK™
OF CANADA

BASEL III PILLAR 3 DISCLOSURES REPORT

For the Quarter Ended July 31, 2023

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Exchange Bank of Canada

Nature of Operations

Established in 2016, Exchange Bank of Canada ("EBC" or "the Bank") is a Schedule 1 Bank and a federally regulated financial institution, wholly owned by Currency Exchange International Corporation, a publicly listed company on the Toronto Stock Exchange (TSX: CXI). The Bank provides a wide range of foreign currency exchange products and international payment services to financial institutions and corporations, including banknote foreign currency exchange, foreign currency cheque clearing, foreign currency bank drafts, electronic funds transfers, and international wire transfers. EBC does not offer deposit accounts nor any lending products. The Bank is domiciled in Canada, with its registered office located at 390 Bay Street, Suite 700, Toronto, Ontario, M5H 2Y2, Canada. The Bank has a fiscal year-end of October 31st.

The Bank generates the following sources of revenue from domestic corporations and financial institutions as well as select foreign financial institutions:

1. Commissions revenue comprise of the difference (spread) between the cost and selling price of foreign currency products, including banknotes, digital currency exchange, cheque collections and draft issuances (foreign currency margin), and the commissions paid on the sale and purchase of currencies. The amount of this spread is based on competitive conditions and the convenience and value-added services offered.
2. Fees collected for wire transfers, electronic fund transmissions, drafts, cheque-clearing transactions, shipping, and other ancillary charges.

Capital Framework

The Basel Committee on Banking Supervision ("BCBS") is an international forum for regular cooperation on banking supervisory matters. Basel III is a global regulatory capital and liquidity framework developed by the BCBS and is composed of the following three pillars:

1. Pillar 1 addresses capital and liquidity adequacy and provides minimum requirements;
2. Pillar 2 outlines supervisory monitoring and review standards; and
3. Pillar 3 promotes market discipline through prescribed public disclosures.

In Canada, the Office of the Superintendent of Financial Institutions ("OSFI") implements the Basel III framework through the (i) Capital Adequacy Requirements ("CAR"); (ii) Leverage Requirements ("LR"); (iii) Liquidity Adequacy Requirements ("LAR"); (iv) Small and Medium-Sized Deposit-Taking Institution ("SMSB") Capital and Liquidity Requirements; and (v) Pillar 3 Disclosure Guideline for SMSBs Capital and Liquidity Requirements.

The Bank is a non-deposit taking and non-lending Schedule 1 Bank, regulated by OSFI. For capital adequacy and liquidity purposes, the Bank is classified as a Category 2 SMSB. Based on CAR, LR, LAR, and the SMSBs Capital and Liquidity Requirements, the Bank applies the standardized approach to credit risk, simplified standardized approach to operational risk, and the standardized approach to counterparty credit risk, to calculate Risk Weighted Assets ("RWA"). The Pillar 3 Disclosure Guideline for SMSBs Capital and Liquidity Requirements require the Bank to publicly disclose relevant disclosures to ensure stakeholders have access to key risk information that would enable them to gain a fundamental understanding and knowledge of the Bank's activities.

Additional information is available here:

1. OSFI's financial Data website: https://www.osfi-bsif.gc.ca/Eng/wt-ow/Pages/fd-df.aspx

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Key metrics

In thousands of Canadian dollars		Q3 2023	Q2 2023	Q1 2023	Q4 2022	Q3 2022
	Available capital (amounts)					
1	Common Equity Tier 1 (CET1)	11,996	12,840	13,109	12,506	11,148
2	Tier 1	11,996	12,840	13,109	12,506	11,148
3	Total capital	16,996	17,840	18,109	17,506	16,148
	Risk-weighted assets (amounts)					
4	Total risk-weighted assets (RWA)	50,586	46,465	47,501	40,334	49,734
	Risk-based capital ratios as a percentage of RWA					
5	CET1 ratio (%)	23.7%	27.6%	27.6%	31.0%	22.4%
6	Tier 1 ratio (%)	23.7%	27.6%	27.6%	31.0%	22.4%
7	Total capital ratio (%)	33.6%	38.4%	38.1%	43.4%	32.5%
	Additional CET1 buffer requirements as a percentage of RWA					
12	*CET1 available after meeting the bank’s minimum capital requirements (%)	7.7%	11.6%	11.6%	15.0%	6.4%
	Basel III Leverage ratio					
13	Total Basel III leverage ratio exposure measure	79,478	87,181	80,096	57,112	76,617
14	Basel III leverage ratio (row 2 / row 13)	15.1%	14.7%	16.4%	22.0%	14.6%

*The Bank’s minimum CET1 capital requirement is 16.0%.

Composition of Capital

	Common Equity Tier 1 capital: instruments and reserves	*In thousands of Canadian dollars*
1	Directly issued qualifying common share capital (and equivalent for non-joint stock companies) plus related stock surplus	16,200
2	Retained earnings	1,405
3	Accumulated other comprehensive income (and other reserves)	-
6	**Common Equity Tier 1 capital before regulatory adjustments**	17,605
	Common Equity Tier 1 capital: regulatory adjustments	
28	**Total regulatory adjustments to Common Equity Tier 1**	5,610
29	**Common Equity Tier 1 capital (CET1)**	11,996
	Additional Tier 1 capital: instruments	**-**
30	Directly issued qualifying Additional Tier 1 instruments plus related stock surplus	-
31	of which: classified as equity under applicable accounting standards	-
32	of which: classified as liabilities under applicable accounting standards	-
36	**Additional Tier 1 capital before regulatory adjustments**	-
	Additional Tier 1 capital: regulatory adjustments	
43	**Total regulatory adjustments to additional Tier 1 capital**	-
44	**Additional Tier 1 capital (AT1)**	-
45	**Tier 1 capital (T1 = CET1 + AT1)**	11,996
	Tier 2 capital: instruments and provisions	
46	Directly issued qualifying Tier 2 instruments plus related stock surplus	5,000
51	**Tier 2 capital before regulatory adjustments**	16,996
	Tier 2 capital: regulatory adjustments	**-**
57	**Total regulatory adjustments to Tier 2 capital**	**-**
58	**Tier 2 capital (T2)**	16,996
59	**Total capital (TC = T1 + T2)**	16,996
60	**Total risk-weighted assets**	50,586
60a	**Credit Valuation Adjustment (CVA) Risk-weighted Assets (RWA)**	
	Capital ratios	
61	Common Equity Tier 1 (as a percentage of risk-weighted assets)	23.7%
62	Tier 1 (as a percentage of risk-weighted assets)	23.7%
63	Total capital (as a percentage of risk-weighted assets)	33.6%
	OSFI target	
69	Common Equity Tier 1 target ratio	7.0%
70	Tier 1 capital target ratio	8.5%
71	Total capital target ratio	10.5%

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Risk Management Objectives, Structure and Policies

The Bank's activities expose it to the following financial risks:

- Credit risk
- Foreign currency risk
- Interest rate risk
- Liquidity risk
- Counterparty Credit risk

Operational risk is the primary non-financial risk that the Bank is exposed to.

Credit Risk

Credit risk is the risk of financial loss associated with the counterparty's inability to fulfill its payment obligations. The Bank's credit risk is primarily attributable to cash in bank accounts, accounts receivable, and forward contracts from hedging counterparties. The Bank maintains accounts in high-quality financial institutions limiting balances that exceed insured limits. The credit risk associated with accounts receivable is limited, as the Bank's receivables consist primarily of bulk currency trades with a settlement cycle of 24 to 48 hours. The majority of the Bank's receivables reside with banks, money service business customers, and other domestic financial institutions, including credit unions. To manage credit risk, customers are grouped into the following categories:

- Domestic and international banks;
- Money service businesses; and
- Other corporate customers.

Credit limits are established for each customer, whereby the credit limit represents the maximum open amount without requiring payments in advance. These limits are reviewed periodically by Senior Management.

Foreign Currency Risk

The Bank is exposed to fluctuations in the value of foreign-denominated assets and liabilities, including contracts to buy or sell foreign currency in the future. Volatility in the Bank's foreign currency holdings may increase because of the political and financial environment of the corresponding issuing country. The Bank's FX policy governs its management of exposure to fluctuations in foreign currency values, including the use of hedges. The policy establishes limits for unhedged exposures of $200,000 and residual exposures for hedged currencies of $100,000. Exposures to foreign currency fluctuations are mitigated by the short-term nature and rapid turnover of foreign currency inventory, as well as the use of forward contracts and options to offset these fluctuations. Due to their nature, certain minor and exotic foreign currencies cannot be hedged or are cost prohibitive to hedge. Foreign currency exposure, in the form of exchange gains and losses arising from normal trading activities and business operations, are included in operating expenses for the period. To mitigate the risks associated with holding these foreign currencies, the Bank assigns wider bid/ask spreads and maintains specific inventory targets to minimize the impact of exchange rate fluctuations. These targets are reviewed regularly and are increased or decreased to accommodate demand within acceptable risk tolerances.

The Bank holds banknote inventory in over 80 currencies. The Bank manages market risk in nine of those holdings using a layered hedging approach. The remaining currencies are managed through a Value at Risk ("VaR") based methodology. VaR limits for unhedged currencies are expressed in the Bank's FX Policy and its Risk Appetite Statement ("RAS") and are managed by the Banknote Operations team, with daily monitoring by its Treasury team. The hedged currencies are managed as part of a layered hedging program that employs natural hedges, forwards, and selective use of purchased options. The Bank's exposures are hedged against its functional reporting currency, CAD. Prior to hedging activity, the

Bank optimizes inventory levels through use of Consignment arrangements with suppliers and back-to-back trades with clients and suppliers.

Interest Rate Risk

The Bank has access to interest-bearing financial instruments in cash and lines of credit. The Bank is subject to a small amount of cash flow interest rate risk from the borrowings on its lines of credit; however, as borrowings have remained steady and within liquidity buffers, this risk is low. Borrowings bear interest at variable rates and currently, the interest rate exposure is unhedged.

Liquidity Risk

Liquidity Risk is the risk of the Bank incurring losses resulting from the inability to meet payment obligations in a timely manner when they become due or from being unable to do so at a sustainable cost. To effectively manage liquidity risk, the Bank has implemented preventative risk monitoring measures, including setting an internal limit for the Liquidity Coverage Ratio ("LCR") of 120% or greater (higher than the regulatory mandated 100%), which measures the proportion of unencumbered highly liquid assets to short-term net cash outflows, and setting a minimum liquidity balance requirement of total available cash or undrawn lines of credit to be greater than $4,000,000 notional daily. As required, the Treasurer reports any liquidity issues to the Chief Executive Officer ("CEO"), Chief Financial Officer ("CFO"), Chief Risk Officer ("CRO"), and the Audit Conduct and Risk Committee ("ACRC") in accordance with established policies and guidelines.

Counterparty Credit Risk

Counterparty Credit Risk ("CCR") is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows, resulting in an economic loss to the Bank. Unlike the Bank's exposure to credit risk, where the exposure to credit risk is unilateral and only the Bank faces the risk of loss, CCR creates a bilateral risk of loss: the market value of the transaction can be positive or negative to either the Bank or the counterparty to the transaction. The market value is uncertain and can vary over time with the movement of underlying market factors.

The Bank recognizes netting in its estimation of exposure at default ("EAD") where it has a master netting agreement in place and other relevant requirements are met. The ISDA Master Agreement is an industry-standard master netting agreement that is typically used to document derivative transactions with counterparty banks and financial institutions. The Bank generally uses the ISDA Master Agreement and similar master netting agreements to document derivative transactions.

For capital adequacy purposes, the Bank applies the Standardized Approach for Counterparty Credit Risk ("SA-CCR") for over the counter ("OTC") foreign exchange derivatives, to compute the RWA calculation. EAD for derivative contracts under SA-CCR is equal to the sum of the replacement cost ("RC") of the derivative and the potential future exposure ("PFE"), multiplied by the alpha factor, as prescribed in the CAR Guideline. The table below presents the EAD and RWA by methodology used for the Bank's determination of regulatory capital for OTC foreign exchange derivative transactions.

In thousands of Canadian dollars		Replacement cost	Potential future exposure	Effective EPE	Alpha used for computing regulatory EAD	EAD post-CRM	RWA
1	SA-CCR (for derivatives)	2,430	7,584	-	1.4	14,634	2,927
6	**Total**	2,430	7,584	-	-	14,634	2,927

Risk weight→	**0%**	**10%**	**20%**	**30 %**	**40 %**	**50 %**	**75 %**	**80 %**	**85 %**	**100 %**	**130 %**	**150%**	**Other s**	**Total credit exposure**
Regulatory portfolio↓														
Sovereigns														
Banks			14,634											2,927
Other assets														
Total														

Operational Risk

Operational risk is the risk of loss resulting from ineffective or failed internal processes, people, systems or external events that can disrupt the flow of business operations. The following are the broad categories of operational risks that are relevant to the Bank:

- Employment Practices and Workplace Safety
- Internal Fraud
- External Fraud and Security of Facilities
- Damage to Physical Assets
- Process Management
- Client, Products, and Business Practices
- Business Disruption and System Failures
- Compliance with laws and regulations

Policies, Framework, Guidelines

The CRO of the Bank has developed an Operational Risk Management ("ORM") Policy to provide a framework and approach for managing operational risks, including processes and control activities, for the various sources of risk present in the operations of the Bank. The Bank's Risk Management Framework ("RMF") includes:

- Board of Directors' approved Risk Appetite Statement ("RAS");
- Policies and procedures implemented to provide reasonable assurance that all material operational risks are identified, measured, monitored, reported, and supported by adequate capital;
- Utilization of operational risk management tools such as risk assessments, operational risks event analysis, scenario analysis etc. to mitigate operational risks for the Bank;
- Periodic risk reporting to appropriate stakeholders;
- Continuous oversight through risk focused committees and governance structure; and
- Implementation of the three lines of defence model to clearly articulate the roles and responsibilities of each line of defence stakeholders.

Governance

The Board of Directors is responsible for the oversight of the Bank's risk management, delegating the primary responsibility to the CRO. The Bank's Senior Management, with oversight from the Board of Directors, is focused on

ensuring best practices are implemented in both operations and compliance with a strong focus on risk, business planning and capital management, with a goal of capital preservation and growth through retained earnings.

Operational Risk Mitigation and Controls

The Bank's appetite and tolerance for operational risk is low. Therefore, all appropriate measures are taken towards achieving a high level of operational risk awareness and establishing a rigorous operational risk management system. To ensure that all applicable risks are identified, assessed, monitored and reported:

- The CRO, in consultation with Senior Management, designs, implements and manages the Bank's ORM strategy and framework;
- The Bank uses various tools, as detailed in OSFI's Guideline E-21: Operational Risk Management, to recognize and understand existing risks and consider risks that may arise from new business initiatives, external market forces, or regulatory or statutory changes;
- A common taxonomy is used to promote consistent risk identification and assessment activities across the Bank;
- The first line of defence designs and implements controls, regularly performs operational risk monitoring activities, promptly detect and report deficiencies in the policies, procedures, and processes, and propose corrective actions;
- The CRO monitors risk thresholds to review risk positions and exceptions, in a timely manner;
- Risk Assessments are undertaken by the first line of defence, to identify key risks relevant to the Bank and control assessments provide reasonable assurance on the design and operating effectiveness of the controls currently in place to mitigate those risks; and
- The CRO periodically reports on the risk environment, detailing all material risks and compliance with the ORM Policy, to the Management Risk Committee, the Board of Directors, and the Risk Committee of the Board of Directors.

Operational Risk Charge

For capital adequacy purposes, the Bank uses the Simplified Standardized Approach ("SSA") to calculate the operational risk charge for RWA calculation.

Previous rolling 12 fiscal quarters (in thousands of Canadian dollars)	**Year 3 (*most recent*)**	**Year 2**	**Year 1**
Lesser of:			
(i) the absolute value of net interest income, and	285		
(ii) 2.25% of interest earning assets	937		
The lesser of the absolute value of net interest income and 2.25% of interest earning assets	285		
Dividend income			
The absolute value of fee and commission income	23,913		
The absolute value of other income	63		
The absolute value of net profit/loss (trading book)			
The absolute value of net profit/loss (banking book)	3,450		
Annual Adjusted Gross Income ("AGI")	27,711	20,390	9,446
	15%	15%	15%
15% of average annual AGI	2,877	3,059	1,417
Beta (b) factor	12.5	12.5	12.5
RWA for operational risk	35,963	38,238	17,713

Leverage Ratio

In thousands of Canadian dollars		Q3 2023	Q2 2023
On-balance sheet exposures			
1	On-balance sheet items (excluding derivatives, SFTs and grandfathered securitization exposures but including collateral)	70,455	72,984
4	(Asset amounts deducted in determining Tier 1 capital)	5,610	5,456
5	**Total on-balance sheet exposures (excluding derivatives and SFTs) (sum of lines 1 to 4)**	64,845	67,528
Derivative exposures			
6	Replacement cost associated with all derivative transactions	3,596	3,524
7	Add-on amounts for potential future exposure associated with all derivative transactions	11,037	16,129
11	**Total derivative exposures (sum of lines 6 to 10)**	14,633	19,653
Capital and total exposures			
20	**Tier 1 capital**	11,996	12,840
21	**Total Exposures (sum of lines 5, 11, 16 and 19)**	79,478	87,181
Leverage ratio			
22	**Basel III leverage ratio**	15.1%	14.7%