

Consolidated Financial Statements of

PACIFIC & WESTERN CREDIT CORP.

Years ended October 31, 2010 and October 31, 2009



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AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of Pacific & Western Credit Corp. as at October 31, 2010 and 2009 and the consolidated statements of operations, comprehensive income (loss), changes in shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at October 31, 2010 and 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants
Saskatoon, Canada

December 7, 2010

PACIFIC & WESTERN CREDIT CORP.

Consolidated Balance Sheet

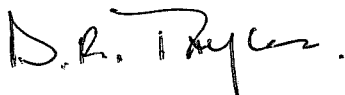
October 31, 2010, and 2009

(thousands of dollars)

	2010	2009
		(restated – note 2)
Assets		
Cash and cash equivalents	\$ 96,989	\$ 172,297
Securities (note 4(a))	234,661	271,660
Loans, net of allowance for credit losses (note 6(a))	964,862	929,831
Other assets (note 7)	26,220	35,132
	<u>\$ 1,322,732</u>	<u>\$ 1,408,920</u>
Liabilities and Shareholders' Equity		
Deposits (note 8)	\$ 1,150,903	\$ 1,217,136
Notes payable (note 9)	75,559	77,933
Other liabilities (note 10)	38,396	71,293
	<u>1,264,858</u>	<u>1,366,362</u>
Preferred share liabilities (note 11)	40,744	27,892
Shareholders' equity:		
Share capital (note 12)	44,054	40,226
Retained earnings (deficit)	(20,548)	(12,407)
Accumulated other comprehensive income (loss)	(6,376)	(13,153)
	<u>17,130</u>	<u>14,666</u>
Commitments and contingencies (note 22)		
	<u>\$ 1,322,732</u>	<u>\$ 1,408,920</u>

See accompanying notes to consolidated financial statements.

On behalf of the Board:



David R. Taylor
President and Chief Executive Officer



C. Scott Ritchie
Chairman of the Board

PACIFIC & WESTERN CREDIT CORP.

Consolidated Statements of Operations

Years ended October 31, 2010 and 2009

(thousands of dollars, except per share amounts)

	2010	2009
Interest income:		
Loans	\$ 44,383	\$ 56,083
Securities	13,493	21,255
Loan fees	4,168	1,660
	<u>62,044</u>	<u>78,998</u>
Interest expense:		
Deposits and other	41,672	64,708
Notes payable	8,355	8,892
Preferred share liabilities	4,499	548
	<u>54,526</u>	<u>74,148</u>
Net interest income	7,518	4,850
Provision for (recovery of) credit losses (note 6(b))	(1,163)	3,449
Net interest income after provision for credit losses	8,681	1,401
Other income (note 14)	349	1,449
Net interest and other income	9,030	2,850
Non-interest expenses:		
Salaries and benefits	7,576	6,942
General and administrative	7,689	5,936
Premises and equipment	2,020	2,089
	<u>17,285</u>	<u>14,967</u>
Loss before income taxes	(8,255)	(12,117)
Income taxes (note 15)	(181)	(2,222)
Net loss	\$ (8,074)	\$ (9,895)
Basic earnings (loss) per share (note 16)	\$ (0.58)	\$ (0.74)
Diluted earnings (loss) per share (note 16)	\$ (0.58)	\$ (0.74)

See accompanying notes to consolidated financial statements.

PACIFIC & WESTERN CREDIT CORP.

Consolidated Statements of Comprehensive Income (Loss)

Years ended October 31, 2010 and 2009

(thousands of dollars)

	2010	2009
Net loss	\$ (8,074)	\$ (9,895)
Other comprehensive income, net of tax		
Net unrealized gains on assets held as available-for-sale ⁽¹⁾	6,992	1,767
Amount transferred to net loss for available-for-sale assets ⁽²⁾	(446)	984
Amount transferred to net loss for impairment writedowns on available-for-sale assets ⁽³⁾	231	-
Other comprehensive income	6,777	2,751
Comprehensive loss	\$ (1,297)	\$ (7,144)

⁽¹⁾ Net of income tax benefit (expense) of (\$2,856) (2009-(\$721)).

⁽²⁾ Net of income tax benefit (expense) of \$390 (2009-(\$413)).

⁽³⁾ Net of income tax benefit (expense) of (\$95) (2009-\$nil).

See accompanying notes to consolidated financial statements.

PACIFIC & WESTERN CREDIT CORP.

Consolidated Statements of Changes in Shareholders' Equity

Years ended October 31, 2010 and 2009

(thousands of dollars)

	2010	2009
		(restated – note 2)
Common shares (note 12):		
Balance, beginning of year	\$ 35,817	\$ 35,663
Issued on payment of Class B preferred share dividend	2,478	154
Balance, end of year	\$ 38,295	\$ 35,817
Preferred shares (note 12):		
<i>Class A preferred shares:</i>		
Balance, beginning of year	\$ 1,061	\$ 3,545
Converted during the year	–	(2,484)
Balance, end of year	\$ 1,061	\$ 1,061
<i>Class B preferred shares:</i>		
Balance, beginning of year	\$ 3,022	\$ –
Issued during the year, net of costs	1,240	3,022
Balance, end of year	\$ 4,262	\$ 3,022
Contributed surplus (notes 12 & 13):		
Balance, beginning of year	\$ 326	\$ 179
Fair value of stock options granted	110	147
Balance, end of year	\$ 436	\$ 326
Retained earnings (deficit):		
Balance, beginning of year	\$ (12,407)	\$ (2,157)
Net loss	(8,074)	(9,895)
Dividends paid	(67)	(355)
Balance, end of year	\$ (20,548)	\$ (12,407)
Accumulated other comprehensive income (loss) net of taxes (note 12):		
Balance, beginning of year	\$ (13,153)	\$ (15,904)
Other comprehensive income	6,777	2,751
Balance, end of year	\$ (6,376)	\$ (13,153)
Total shareholders' equity	\$ 17,130	\$ 14,666

See accompanying notes to consolidated financial statements.

PACIFIC & WESTERN CREDIT CORP.

Consolidated Statements of Cash Flows

Years ended October 31, 2010 and 2009

(thousands of dollars)

	2010	2009
Cash provided by (used in):		
Operations:		
Net loss	\$ (8,074)	\$ (9,895)
Items not involving cash:		
Provision for (recovery of) credit losses	(1,163)	3,449
Impairment writedown on securities	326	-
Change in derivative financial instruments	(246)	296
Future income tax recovery	(181)	(2,222)
Stock-based compensation	110	147
Gain on disposal of securities	(2,641)	(9,970)
Gains realized on securitization	(1,348)	-
Unrealized losses on held for trading securities	499	-
Interest expense on preferred share liabilities	2,478	154
Gain on real estate held for sale	(267)	(626)
Loss on sale of available-for-sale assets	463	-
Change in other assets and liabilities	18,813	(6,157)
	8,769	(24,824)
Investing:		
Purchase of securities	(680,187)	(975,356)
Proceeds from sale and maturity of securities	726,870	876,806
Loans	(56,303)	178,043
Proceeds from mortgage securitizations	24,332	-
Securitization retained interests	2,383	-
	17,095	79,493
Financing:		
Deposits	(66,233)	(172,319)
Other financings	(46,578)	46,578
Notes payable	(2,612)	35,893
Preferred share liabilities	14,318	-
Dividends paid	(67)	(355)
	(101,172)	(90,203)
Decrease in cash and cash equivalents	(75,308)	(35,534)
Cash and cash equivalents, beginning of year	172,297	207,831
Cash and cash equivalents, end of year	\$ 96,989	\$ 172,297
Supplementary cash flow information:		
Interest paid during the year	\$ 52,137	\$ 77,598
Income taxes paid during the year	\$ -	\$ -

See accompanying notes to consolidated financial statements.

PACIFIC & WESTERN CREDIT CORP.

Notes to Consolidated Financial Statements

Years ended October 31, 2010 and 2009

Pacific & Western Credit Corp. (the "Corporation"), is a holding company whose shares trade on the Toronto Stock Exchange. Its wholly-owned and principal subsidiary is Pacific & Western Bank of Canada ("PWB" or the "Bank") which operates as a Schedule I bank under the *Bank Act (Canada)*. Pacific & Western Bank of Canada is involved in the business of providing financial solutions to clients in selected niche markets.

1. Significant accounting policies:

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the balance sheet date and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The significant accounting principles used in the preparation of these consolidated financial statements are summarized below:

a) Investments:

The Corporation holds 100% of the common shares of Pacific & Western Bank of Canada, Arctic Financial Ltd., PW Capital Inc., Pacific & Western Public Sector Financing Corp. and Versabanq Innovations Inc. The consolidated financial statements include the accounts of these subsidiaries.

All significant intercompany accounts and transactions have been eliminated.

b) Variable Interest Entities:

Variable interest entities ("VIE's") are consolidated in situations where the Corporation is determined to be the primary beneficiary. A VIE is defined as an entity which either does not have sufficient equity at risk to finance its activities without additional subordinated financial support or where the holders of the equity at risk lack the characteristics of a controlling financial interest.

c) Cash and cash equivalents:

Cash and cash equivalents include government treasury bills and deposits with Canadian chartered banks with less than ninety days to maturity from the date of acquisition, net of cheques and other items in transit.

PACIFIC & WESTERN CREDIT CORP.

Notes to Consolidated Financial Statements

Years ended October 31, 2010 and 2009

1. Significant accounting policies - continued:

d) Securities:

Settlement date accounting is used for all securities.

The Corporation holds securities for investment purposes with the original intention of holding the securities to maturity or until market conditions render alternative investments more attractive. The Corporation accounts for securities as either held-to-maturity, held for trading or as available-for-sale (see note 1(m)). Any impairment in the underlying value of securities, other than a temporary impairment, is recorded as a charge to income in the year in which it occurs.

e) Loans:

Loans are initially measured at fair value plus incremental direct transaction costs. Loans are subsequently re-measured at their amortized cost, net of allowance for credit losses, using the effective interest method.

Interest income is accounted for on the accrual basis, except on loans classified as impaired. A loan is classified as impaired when, in management's opinion, there has been deterioration in credit quality to the extent that there is no longer reasonable assurance as to the timely collection of the full amount of principal and interest. Loans where interest or principal is contractually past due 90 days are automatically recognized as impaired, unless management determines that the loan is fully secured, in the process of collection and the collection efforts are reasonably expected to result in either repayment of the loan or restoring it to a current status within 180 days from the date the payment has become contractually in arrears. All loans are classified as impaired when interest or principal is past due 180 days, except for loans guaranteed or insured by the Canadian government, provinces, territories, or a Canadian government agency, which are classified as impaired when interest or principal is contractually 365 days in arrears.

When a loan is classified as impaired, accrual of interest on the loan ceases and the carrying amount of the loan is reduced to its estimated realizable amount. Estimated realizable amounts are measured by discounting the expected future cash flows, if they can be reasonably estimated, using the effective interest rate inherent in the loan. When the amounts and timing of cash flows cannot be reasonably estimated, the carrying amount of the loan is reduced to its estimated net realizable value based on either:

- i) the fair value of any security underlying the loan, net of expected costs of realization, and,
- ii) observable market prices for the loan.

PACIFIC & WESTERN CREDIT CORP.

Notes to Consolidated Financial Statements

Years ended October 31, 2010 and 2009

1. Significant accounting policies - continued:

e) Loans - continued:

As long as the loan remains classified as impaired, payments received will be credited to the carrying value of the loan. A loan will be returned to accrual status only when the timely collection of both principal and interest is reasonably assured and all arrears payments of principal and interest are brought current.

Loan fees in excess of estimated administrative costs are considered to be adjustments to loan yields and are recognized in income over the appropriate lending or commitment period.

Real estate acquired as settlement of loans is stated at fair value based on appraised values or prices for similar assets.

f) Allowance for credit losses:

The Corporation maintains an allowance for credit losses which, in management's opinion, is adequate to absorb all credit related losses in its portfolio of both on and off-balance sheet items. The allowance for credit losses consists of specific provisions, being provisions against specific credit exposures determined on an item-by-item basis, and a general provision for losses which have occurred but where such losses cannot be determined on an item-by-item basis.

In assessing existing credit losses, management must rely on estimates and exercise judgement regarding matters for which the ultimate outcome is unknown. Changes in circumstances may cause future assessments of credit risk to be significantly different than current assessments and may require an increase or decrease in the allowance for credit losses.

g) Capital assets:

Capital assets are carried at cost less accumulated amortization. Costs of additions and betterments are capitalized.

Amortization is calculated using the straight-line method over the estimated useful lives of assets ranging from five to twenty years.

h) Securities sold under repurchase agreements:

Securities sold under repurchase agreements represent short term financing transactions where the Corporation sells securities that it already owns and simultaneously commits to repurchase the securities at a specified price on a specified date in the future.

PACIFIC & WESTERN CREDIT CORP.

Notes to Consolidated Financial Statements

Years ended October 31, 2010 and 2009

1. Significant accounting policies - continued:

i) Income taxes:

The Corporation follows the asset and liability method of accounting for income taxes. Future 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.

j) Stock-based compensation:

Employee stock options are accounted for using the fair value method which recognizes the fair value of the stock option over the applicable vesting period as an increase in salaries and benefits expense. The Corporation's stock option plan is described in note 13.

For deferred share units that call for settlement in cash, the Corporation records a charge to salaries and benefits expense for the difference between the market value of the Corporation's common shares and the option price, if any. Changes in the market value of the Corporation's common shares result in a change in the measure of compensation for the units. Deferred share units granted by the Corporation are described in note 13.

The Corporation accounts for grants of warrants to non-employees in accordance with the fair value method.

k) Derivative instruments:

Derivatives are carried at fair value and are reported as other assets when they have a positive fair value and as other liabilities when they have a negative fair value. Derivatives may be embedded in other financial instruments. Derivatives embedded in other financial instruments are valued as separate derivatives when their economic characteristics and risks are not clearly and closely related to those of the host contract; the terms of the embedded derivative would meet the definition of a derivative if it was a free standing instrument; and the combined contract is not held for trading or designated at fair value. For financial statement disclosure purposes the embedded derivatives are combined with the host contract.

Interest rate swap agreements are entered into for asset liability management ("ALM") purposes.

When hedge accounting criteria are met, derivative contracts are accounted for as described below.

To meet the criteria for hedge accounting, the Corporation documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives to specific assets or liabilities on the Consolidated Balance Sheets or to specific

PACIFIC & WESTERN CREDIT CORP.

Notes to Consolidated Financial Statements

Years ended October 31, 2010 and 2009

1. Significant accounting policies - continued:

k) Derivative instruments (continued):

firm commitments or forecasted transactions. The Corporation also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are effective in offsetting changes in fair values or cash flows of hedged items.

There are three main types of hedges: (i) fair value hedges, (ii) cash flow hedges and (iii) net investment hedges.

At October 31, 2010 and 2009, the Corporation had only fair value hedges outstanding. In a fair value hedge, the change in the fair value of the hedging derivative is offset in the Consolidated Statements of Operations by the changes in the fair value of the hedged item relating to the hedged risk. The Corporation utilizes fair value hedges primarily to convert fixed rate financial assets to floating rates. The main financial instrument designated in fair value hedging relationships consists of loans. If the derivative expires or is sold, terminated, no longer meets the criteria for hedge accounting, or the designation is revoked, hedge accounting is discontinued. Any adjustment up to that point to a hedged item for which the effective interest method is used, is amortized to the Consolidated Statements of Operations as part of the recalculated effective interest rate of the item over its remaining term.

Any hedge ineffectiveness is measured and recorded in the current period net interest income in the Consolidated Statements of Operations.

Derivative contracts which do not qualify for hedge accounting are marked-to-market and the resulting net gains or losses are recognized in other income in the Consolidated Statements of Operations in the current year.

l) Administrative and other income:

Administrative and other income is recognized on an accrual basis as services are performed.

m) Financial instruments

All financial assets are classified as one of the following: held-to-maturity, held for trading, available-for-sale or loans and receivables. All financial liabilities are classified as held for trading or other liabilities. Financial assets and liabilities held for trading are measured at fair value with gains and losses recognized in net income. Financial assets that are classified as held-to-maturity, loans and receivables and financial liabilities other than those held for trading, are measured at amortized cost based on the effective interest method. Available-for-sale instruments are measured at fair value with gains and losses, net of tax, recognized in other comprehensive income.

PACIFIC & WESTERN CREDIT CORP.

Notes to Consolidated Financial Statements

Years ended October 31, 2010 and 2009

1. Significant accounting policies - continued:

n) Transaction costs

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or liability. Transaction costs related to available-for-sale, held-to-maturity securities, loans and deposit liabilities are capitalized and amortized over the expected life of the instrument using the effective interest method.

o) Securitization transactions:

For each securitization transaction, where the Corporation retains the servicing rights, an asset is recognized as securitization retained interests on the Consolidated Balance Sheets. Securitization retained interests are investments classified as available-for-sale securities and are carried at fair value with changes in fair value reported in other comprehensive income, net of income taxes.

When mortgages are sold in a securitization transaction under terms that transfer control to third parties, the transaction is recorded as a sale and related mortgage assets are removed from the Consolidated Balance Sheets. In the securitization transaction, certain interests are retained, including the right to receive the future excess interest spread and the mortgage servicing obligation. The servicing liability is included in other liabilities. A gain or loss on the sale of mortgages is recognized immediately in the Consolidated Statements of Operations. The amount of the gain or loss recognized depends in part on the previous carrying amount of the mortgages involved in the transfer allocated between the assets sold and the retained interests based on their relative fair values at the date of transfer. To obtain fair values, the Corporation uses estimates based on estimates of key assumptions including prepayment rates and discount rates commensurate with the risks involved.

2. Amendment to Financial Statements:

Opening retained earnings (deficit) for the years ending October 31, 2010 and 2009 have been restated to reflect an amendment to the Corporation's earnings for the year ended October 31, 2008 as a result of a change in accounting with respect to the separation of an embedded derivative contained in a collateralized debt obligation (CDO), an investment in the Corporation's securities portfolio. This change in accounting has been applied retrospectively to November 1, 2006 and was a result of a commentary issued by the CICA Accounting Standards Board Staff in February of 2009 clarifying application of Section 3855 – *Financial Instruments* of the CICA Handbook and reflecting the conclusions of the commentary. The change in accounting should have been applied to the Corporation's 2009 fiscal year.

PACIFIC & WESTERN CREDIT CORP.

Notes to Consolidated Financial Statements

Years ended October 31, 2010 and 2009

2. Amendment to Financial Statements – continued:

During the year ending October 31, 2010, the Corporation re-examined contractual aspects of the CDO which the Corporation had purchased in 2006 and reclassified to the held-to-maturity category from the available-for-sale category on August 1, 2008. Based on this re-examination, the Corporation concluded that the investment in the CDO contained an embedded derivative which under the CICA commentary issued in 2009, should have been separated retroactively to the adoption of Section 3855 on November 1, 2006. As a result, the Corporation has retrospectively amended its accounting with respect to its investment in the CDO. The impact of this change in accounting is that the earnings (loss) of the Corporation for the year ended October 31, 2008 have been adjusted to (\$26.0 million) from the previously reported amount of (\$20.0 million). Accordingly, ending retained earnings (deficit) for the Corporation as at October 31, 2008 has been adjusted from \$3.8 million to (\$2.2 million) and Accumulated Other Comprehensive Income (Loss) has been adjusted from (\$19.1 million) to (\$15.9 million). In addition, total Shareholders' Equity has been adjusted from \$24.1 million to \$21.3 million. Basic and diluted earnings (loss) per share for the year ended October 31, 2008 have been adjusted to (\$1.93) from the previously reported amount of (\$1.49). The impact on the results of the Corporation for the year ended October 31, 2009 has been determined not to be material.

As a result of the above, opening retained earnings (deficit) of the Corporation for the year ended October 31, 2010 has been adjusted from (\$6.4 million) to (\$12.4 million) and Accumulated Other Comprehensive Income (Loss) has been adjusted from (\$16.3 million) to (\$13.1 million). The overall impact to total Shareholders' Equity as a result of the above was a decrease of approximately \$2.8 million.

3. Future accounting changes:

International Financial Reporting Standards:

The Canadian Institute of Chartered Accountants will transition Canadian GAAP for publicly accountable entities to IFRS. The Corporation's consolidated financial statements will be prepared in accordance with IFRS for the fiscal year commencing November 1, 2011.

The Corporation continues its process of transition from current Canadian GAAP to IFRS. It has a project team assigned to plan for and achieve a smooth transition to IFRS. Regular reporting to the Audit Committee of the Board of Directors on the status of the IFRS implementation continues to take place. The Corporation also provides frequent updates of its IFRS implementation status to its external auditors and to the Office of Superintendent of Financial Institutions (OSFI).

PACIFIC & WESTERN CREDIT CORP.

Notes to Consolidated Financial Statements

Years ended October 31, 2010 and 2009

3. Future accounting changes (continued):

The implementation project consists of three phases which include: research, diagnostic and planning phase; impact analysis, evaluation and design phase; and implementation, training and review phase. The Corporation has completed the research, diagnostic and planning phase, including the establishment of a detailed timetable with benchmarks, and has completed several aspects of the impact analysis, evaluation and design phase. The results thus far of the Corporation's analysis of IFRS and comparison with Canadian GAAP have identified several differences. However the differences identified thus far are not expected to have a material impact on the reported results and financial position of the Corporation other than those differences relating to derecognition of transfers of certain financial assets as discussed below. The impact of these differences is dependent on the value of financial assets transferred and the choice made by the Corporation as to the implementation date of the derecognition standard.

Under IFRS, certain financial assets that previously qualified for derecognition on transfer are expected to be re-recognized. This would result in an adjustment to retained earnings intended to unwind the previously reported impact of all securitization transactions undertaken and retroactively re-recognize the assets that were previously considered to have been sold as amortizing assets that continue to reside on the Consolidated Balance Sheets, earning spread income over their term. The International Accounting Standards Board has recently changed the implementation date of the derecognition standard to allow entities to select their date of transition to IFRS as the implementation date of the derecognition standard. The Corporation expects to select their date of transition to IFRS as their implementation date of the derecognition standard and as a result will not be required to re-recognize assets that were sold prior to October 31, 2010.

As the Corporation prepares for its transition to IFRS, it continues to monitor ongoing changes to IFRS and adjust its transition and implementation plans accordingly. The Corporation's transition remains in line with its implementation schedule and is on track to meet the timelines essential to changeover.

PACIFIC & WESTERN CREDIT CORP.

Notes to Consolidated Financial Statements

Years ended October 31, 2010 and 2009

4. Securities:

a) Portfolio analysis:

(thousands of dollars)

	2010	2009
	(restated – note 2)	
Available-for-sale securities		
Securities issued or guaranteed by:		
Canadian federal government	\$ 32,691	\$ 88,873
Canadian provinces	26,341	46,256
Canadian municipalities	5,359	21,406
Corporate debt	100,443	43,702
Corporate equity	66,645	69,489
Retained interests (note 5)	2,542	–
Total available-for-sale securities	234,021	269,726
Held-to-maturity security		
Corporate debt	\$ 640	\$ 1,934
Total securities	\$ 234,661	\$ 271,660

4. Securities – continued:

b) Maturities and yields:

(thousands of dollars)

Maturity dates	2010	Yield	2009	Yield
	(restated- note 2)			
Available-for-sale securities				
Floating	\$ 28,100	2.09%	\$ 26,224	1.95%
Within 3 months	4,672	1.83%	33	5.93%
3 months - 1 year	67,069	1.26%	8,609	1.93%
1 year - 2 years	82,795	3.52%	99,536	1.52%
2 years - 5 years	23,326	4.20%	113,486	3.65%
Over 5 years	28,059	4.03%	21,838	4.29%
Total available-for-sale securities	\$ 234,021	2.80%	\$ 269,726	2.70%
Held-to-maturity security				
2 years – 5 years	\$ 640	11.32%	\$ 1,934	6.14%
Total securities	\$ 234,661	2.82%	\$ 271,660	2.72%

Average effective yields are based on carrying values and contractual interest or stated dividend rates adjusted for amortization of premiums and discounts.

PACIFIC & WESTERN CREDIT CORP.

Notes to Consolidated Financial Statements

Years ended October 31, 2010 and 2009

4. Securities – continued:

c) Unrealized gains and losses on securities:

(thousands of dollars)

	2010				2009			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Carrying Value	Amortized Cost	Unrealized Gains	Unrealized Losses (restated- note 2)	Carrying Value (restated- note 2)
Available-for-sale securities								
Securities issued or guaranteed by:								
Canadian federal government	\$ 32,681	\$ 19	\$ (9)	\$ 32,691	\$ 87,930	\$ 996	\$ (53)	\$ 88,873
Canadian provinces	26,244	97	–	26,341	46,159	120	(23)	46,256
Canadian municipalities	5,311	52	(4)	5,359	21,230	198	(22)	21,406
Corporate debt	101,068	1,931	(2,556)	100,443	45,954	837	(3,089)	43,702
Corporate equity	75,142	2	(8,499)	66,645	86,324	–	(16,835)	69,489
Retained interests	2,199	343	–	2,542	–	–	–	–
Total available-for-sale securities	\$ 242,645	\$ 2,444	\$ (11,068)	\$234,021	\$ 287,597	\$ 2,151	\$ (20,022)	\$ 269,726
Held-to-maturity security								
Corporate debt	\$ 10,000	\$ –	\$ (9,360)	\$ 640	\$ 10,000	\$ –	\$ (8,066)	\$ 1,934
Total securities	\$ 252,645	\$ 2,444	\$ (20,428)	\$ 234,661	\$ 297,597	\$ 2,151	\$ (28,088)	\$ 271,660

The carrying values of available-for-sale securities are represented by fair values and are based on quoted market prices for securities and an internal valuation model is used for retained interests. The held-to-maturity security consists of a host contract with an amortized cost of \$10,000,000 (2009 - \$10,000,000) and a related embedded derivative with an estimated fair value of (\$9,360,000) (2009 – (\$8,066,000)). These amounts have been combined for financial statement disclosure purposes. The embedded derivative is classified as held for trading instrument and its fair value is estimated by the use of an external valuation model.

The Corporation conducts a quarterly review to identify and evaluate investments that show indications of possible impairment. An investment is considered impaired if its fair value falls below its cost, and a writedown to fair value is recorded when the decline is considered other than temporary. Factors considered in determining whether a loss is temporary include the length of time and extent to which fair value has been below cost, financial conditions and near-term prospects of the issuer, and the ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery.

Market conditions have resulted in a decline in the market value of equity securities held by the Corporation for investment purposes. These securities, consisting primarily of preferred shares of major Canadian banks and insurance companies, are subject to market fluctuations and, at October 31, 2010, traded at a value of approximately (\$8,499,000) (2009 – (\$16,835,000)) below their amortized cost. The Corporation has recorded this amount

PACIFIC & WESTERN CREDIT CORP.

Notes to Consolidated Financial Statements

Years ended October 31, 2010 and 2009

4. Securities – continued:

c) Unrealized gains and losses on securities (continued):

net of applicable income taxes, in accumulated other comprehensive income (loss). The Corporation intends to hold these securities until redemption or until a recovery in value is achieved. The securities have provisions that will allow the issuer to redeem the securities at various dates commencing over the years 2011 to 2014; however, there is no promise or legal requirement for the issuers of the preferred shares to redeem these shares on those dates. Recovery of the market value decline is dependent upon future market conditions or the ultimate future redemption of the shares by the issuers.

d) Fair value hierarchy:

The Corporation follows a fair value hierarchy to categorize the inputs used to measure fair value for its securities. The fair value hierarchy is based on quoted prices in active markets (Level 1), models using inputs other than quoted prices (Level 2), or models using inputs that are not based on observable market data (Level 3).

Securities are classified into the fair value hierarchy as follows:

2010				
	Total	Level 1	Level 2	Level 3
Available-for-sale securities:				
Equity securities	\$ 66,645	\$ 66,645	\$ –	\$ –
Debt securities ⁽¹⁾	167,376	59,032	108,344	–
	<u>\$ 234,021</u>	<u>\$125,677</u>	<u>\$108,344</u>	<u>\$ –</u>
Held-to-maturity security:				
Debt security	\$ 640	\$ –	\$ –	\$ 640
	<u>\$ 234,661</u>	<u>\$125,677</u>	<u>\$108,344</u>	<u>\$ 640</u>
2009				
	Total	Level 1	Level 2	Level 3
Available-for-sale securities:				
Equity securities	\$ 69,489	\$ 69,489	\$ –	\$ –
Debt securities ⁽¹⁾	200,237	135,129	65,108	–
	<u>\$ 269,726</u>	<u>\$204,618</u>	<u>\$ 65,108</u>	<u>\$ –</u>
Held-to-maturity security:				
Debt security	\$ 1,934	\$ –	\$ –	\$ 1,934
	<u>\$ 271,660</u>	<u>\$204,618</u>	<u>\$ 65,108</u>	<u>\$ 1,934</u>

(1) Level 1 debt securities include Canadian federal and provincial government debt and insured mortgage-backed securities. Level 2 debt securities include municipal government and corporate debt and retained interests. The Level 3 debt security

PACIFIC & WESTERN CREDIT CORP.

Notes to Consolidated Financial Statements

Years ended October 31, 2010 and 2009

4. Securities – continued:

d) Fair value hierarchy – continued:

consists of an embedded derivative with the host contract of a collateralized debt obligation. The change in value from the previous year was due to a decrease in the fair value of the security and was reflected in the Consolidated Statement of Operations.

5. Securitization activities:

The Corporation securitizes Government of Canada guaranteed residential mortgages through the creation of mortgage-backed securities and removes the mortgages from its consolidated balance sheet. As at October 31, 2010, outstanding securitized mortgages totalled \$24,126,000 (2009 - \$nil).

Retained interests are accounted for at the settlement date. The fair value of the retained interest is determined with internal valuation models using market data inputs, where possible, by discounting the expected future cash flows at similar Government of Canada bond interest rates plus a spread. The Corporation has assumed no credit risk for purposes of measuring its retained interest since all mortgages securitized to date are Government of Canada guaranteed.

During the year ended October 31, 2010, mortgages securitized and sold totalled \$24,368,000 (2009 - \$nil) for cash proceeds of \$24,332,000 (2009 - \$nil). The amortized cost of retained rights to future excess interest totalled \$2,383,000 (2009 - \$nil) and the servicing liability recorded totalled \$181,000 (2009 - \$nil). At October 31, 2010, the retained interests had a fair value of \$2,542,000. The weighted-average key assumptions used in measuring the retained interests at the date of securitization included a discount rate of 2.78% and a rate of 1.42% for the excess spread. It was determined that a 10% and a 20% adverse change in the discount rate used to determine the carrying value of the retained interests would not have a material impact on the financial position of the Corporation.

Gains on mortgages securitized and sold totalled \$1,348,000 (2009 - \$nil) and are included in other income in the Consolidated Statement of Operations.

PACIFIC & WESTERN CREDIT CORP.

Notes to Consolidated Financial Statements

Years ended October 31, 2010 and 2009

6. Loans:

a) Portfolio analysis:

(thousands of dollars)

	2010	2009
Residential mortgages:		
Insured	\$ 62,838	\$ 60,165
Uninsured	159,798	124,558
Corporate and government loans	735,570	738,009
Personal loans	7,430	12,656
	965,636	935,388
Allowance for credit losses:		
General	(3,812)	(8,401)
Specific	(1,048)	(1,133)
	(4,860)	(9,534)
	960,776	925,854
Accrued interest	4,086	3,977
	\$ 964,862	\$ 929,831

The general allowance for credit losses relates to the following loan portfolios: residential mortgages - \$339,000 (2009 - \$381,000); corporate and government loans - \$1,935,000 (2009 - \$2,259,000) personal loans - \$1,538,000 (2009 - \$5,761,000).

Loans are secured primarily by collateral mortgages against real estate with respect to real estate lending and specific charges against equipment being financed for other lending activities.

b) Allowance for credit losses:

The allowance for credit losses results from the following:

(thousands of dollars)

			2010	2009
	General	Specific	Total Allowance	Total Allowance
Balance, beginning of year	\$ 8,401	\$ 1,133	\$ 9,534	\$ 6,042
Provision for (recovery of) credit losses	(1,259)	96	(1,163)	3,449
Recoveries (write-offs)	(3,330)	(181)	(3,511)	43
Balance, end of year	\$ 3,812	\$ 1,048	\$ 4,860	\$ 9,534

PACIFIC & WESTERN CREDIT CORP.

Notes to Consolidated Financial Statements

Years ended October 31, 2010 and 2009

6. Loans – continued:

c) Maturities and yields:

(thousands of dollars)

	Floating	Within 3 months	3 months to 1 year	1 year to 2 years	2 years to 5 years	Over 5 years	2010 Total	2009 Total
Total loans	\$ 264,064	\$ 38,952	\$ 38,509	\$ 111,725	\$ 264,833	\$ 247,553	\$ 965,636	\$ 935,388
Average effective yield	4.82%	6.23%	5.59%	5.37%	5.61%	5.54%	5.37%	5.25%
Adjusted for related derivatives	4.82%	6.23%	5.59%	4.48%	5.42%	3.36%	4.66%	4.11%

Average effective yields are based on book values and contractual interest rates, adjusted for the amortization of any deferred income.

d) Impaired loans:

(thousands of dollars)

	Gross Impaired	Specific Allowance	2010 Net Impaired	Gross Impaired	Specific Allowance	2009 Net Impaired
Residential mortgages	\$ 1,022	\$ 850	\$ 172	\$ 1,076	\$ 811	\$ 265
Corporate and government loans	–	–	–	1,629	–	1,629
Personal loans	2,230	198	2,032	3,690	322	3,368
	\$ 3,252	\$ 1,048	\$ 2,204	\$ 6,395	\$ 1,133	\$ 5,262

Impaired loans include foreclosed real estate held for sale with a gross carrying value of \$149,000 (2009 - \$1,844,000) and a related allowance of \$110,000 (2009 - \$71,000).

Loans past due but not impaired totaled \$nil (2009-\$969,000).

PACIFIC & WESTERN CREDIT CORP.

Notes to Consolidated Financial Statements

Years ended October 31, 2010 and 2009

7. Other assets:

(thousands of dollars)

	2010	2009
		(restated – note 2)
Future income tax asset (note 15)	\$ 10,715	\$ 12,674
Capital assets	5,710	6,731
Prepaid expenses and other	7,720	8,108
Investment in Discovery Air Inc.	1,295	2,603
Accounts receivable	780	5,016
	\$ 26,220	\$ 35,132

At October 31, 2010, the investment in Discovery Air Inc. (DA) had a fair value of \$1,295,000 (2009-\$2,603,000) with fair value being determined based on quoted market prices and therefore falls into Level 1 on the fair value hierarchy (note 3(d)).

8. Deposits:

(thousands of dollars)

	Floating	Within 3 months	3 months to 1 year	1 year to 2 years	2 years to 5 years	Accrued Interest	2010 Total	2009 Total
Total deposits	\$ 36,187	\$ 108,743	\$ 542,085	\$ 343,196	\$ 108,674	\$ 12,018	\$1,150,903	\$ 1,217,136
Average effective interest rate	1.05%	1.41%	2.15%	2.74%	3.46%		2.34%	2.57%

Average effective interest rates are based on book values and contractual interest rates.

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Notes to Consolidated Financial Statements

Years ended October 31, 2010 and 2009

9. Notes payable:

(thousands of dollars)

	2010	2009
Ten year term Series C Notes unsecured, maturing 2018, net of note issue costs of \$1,205 (2009 - \$1,305), effective interest of 10.71%	\$ 50,592	\$ 50,220
Ten year term Series A Notes, unsecured, maturing 2010, net of note issue costs of \$nil (2009 - \$15), effective interest of 10.47%	–	2,597
Notes payable, unsecured, maturing 2012, net of note issue costs of \$258 (2009 - \$30) effective interest of 7.8% (2009 – 7.8%)	4,942	5,170
Ten year term, unsecured, callable, subordinated notes payable by the Bank to a third party, maturing 2019, net of note issue costs of \$1,475 (2009 - \$1,554), effective interest of 12.37%	20,025	19,946
	\$ 75,559	\$ 77,933

During the year ended October 31, 2009, \$5.6 million of Series A Notes were converted into \$6.8 million of Series C Notes. In addition, \$3.3 million of Series A Notes and \$27.4 million of Series C Notes were converted into Class B Preferred Shares (note 12(b)).

10. Other liabilities:

(thousands of dollars)

	2010	2009
Securities sold under repurchase agreements	\$ –	\$ 46,578
Fair value of derivatives (note 17)	19,907	17,887
Cash collateral and amounts held in escrow	12,277	1,499
Accounts payable and other	6,212	5,329
	\$ 38,396	\$ 71,293

The fair value of derivatives was determined using models with observable market data and therefore falls into Level 2 on the fair value hierarchy (note 4(d)).

PACIFIC & WESTERN CREDIT CORP.

Notes to Consolidated Financial Statements

Years ended October 31, 2010 and 2009

11. Preferred share liabilities:

At October 31, 2010, the Corporation has outstanding 1,909,458 (2009 – 1,326,558) Class B Preferred Shares with a total value of \$47.7 million (2009 - \$33.2 million) less issue costs of \$2.7 million (2009 – \$2.3 million). As these Class B preferred shares carry certain redemption features and are convertible into common shares of the Corporation, an amount of \$40.7 million (2009 - \$27.9 million), net of issue costs, representing the fair value of the Corporation's obligation to make future payments of principal and interest has been classified on the Corporation's Consolidated Balance Sheet as a preferred share liability. In addition, an amount of \$4.3 million (2009 – \$3.0 million) representing the equity element of the Class B Preferred Shares, net of issue costs, has been classified in share capital on the Consolidated Balance Sheet (note 12 (b)).

As the preferred shares can be redeemed by the Corporation for approximately \$47.7 million (2009 – \$33.2 million), the preferred share liability amount of \$40.7 million (2009 – \$27.9 million) is being increased over the remaining term to redemption, until the liability amount is equal to the estimated redemption amount with the increase included in interest expense in the Consolidated Statement of Operations calculated using the effective interest rate of 11.8%.

12. Share capital:

a) Authorized:

Common shares:

The Corporation is authorized to issue an unlimited number of common shares.

Class A preferred shares:

The Corporation is authorized to issue an unlimited number of Class A Preferred Shares. These shares are entitled to receive a cumulative dividend at the rate of \$0.21 per share per annum. These shares are non-voting, non-participating and redeemable at the option of the Corporation at the issue price and are convertible into common shares on the basis of 4.608 preferred shares for 1 common share. At October 31, 2010, cumulative and unpaid dividends on the Class A Preferred Shares totalled \$62,000 (2009 - \$62,000).

Class B preferred shares:

The Corporation is authorized to issue an unlimited number of Class B Preferred Shares. The shares are non-voting and are subordinate to the Class A Preferred Shares with respect to the payment of dividends and the distribution of assets on dissolution, liquidation or winding-up. The Class B Preferred Shares have preferential rights over the common shares with respect to the payment of dividends and the distribution of assets on dissolution, liquidation or winding-up.

PACIFIC & WESTERN CREDIT CORP.

Notes to Consolidated Financial Statements

Years ended October 31, 2010 and 2009

12. Share capital – continued:

a) Authorized (continued):

The Class B Preferred Shares are convertible, at any time, into common shares of the Corporation on the basis of five (5) common shares for each Class B Preferred Share. Upon conversion, all accrued and unpaid dividends, calculated by excluding the date fixed for conversion, shall be payable by the Corporation in cash/common shares, in the manner described below with respect to dividends.

The holders of Class B Preferred Shares are entitled to receive, and the Corporation shall pay thereon, as and when declared by the Board of Directors of the Corporation, fixed subordinated cumulative dividends at the rate of \$2.25 per share per annum. Out of the total dividend of \$2.25 per annum per Class B Preferred Share, \$0.84 will be paid by the Corporation in cash with remaining dividends to be paid by the Corporation in cash or common shares of the Corporation, at the Corporation's sole discretion.

The Class B Preferred Shares are redeemable by the Corporation, at its discretion, on or after June 30, 2014, but will be redeemed by the Corporation by no later than June 30, 2019, in each case for \$25.00 per Class B Preferred Share (the "Redemption Price"). Any redemption price would be paid by the Corporation in cash, and any accrued but unpaid dividends on the Class B Preferred Shares that are redeemed shall be payable by the Corporation in cash/common shares, in the manner described above with respect to dividends.

PACIFIC & WESTERN CREDIT CORP.

Notes to Consolidated Financial Statements

Years ended October 31, 2010 and 2009

12. Share capital – continued:

b) Issued and outstanding:

(thousands of dollars)

	2010		2009	
	Shares	Amount	Shares	Amount
<i>Common shares:</i>				
Outstanding, beginning of year	13,680,412	\$ 35,817	13,642,452	\$ 35,663
Shares issued on payment of Class B preferred share dividend	753,830	2,478	37,960	154
Outstanding, end of year	14,434,242	\$ 38,295	13,680,412	\$ 35,817
<i>Class A preferred shares:</i>				
Outstanding, beginning of year	314,572	\$ 1,061	1,142,556	\$ 3,545
Converted during the year	–	–	(827,984)	(2,484)
Outstanding, end of year	314,572	\$ 1,061	314,572	\$ 1,061
<i>Class B preferred shares:</i>				
Outstanding, beginning of year	1,326,558	\$ 3,022	–	\$ –
Issued during the year (note 11)	582,900	1,240	1,326,558	3,022
Outstanding, end of year	1,909,458	\$ 4,262	1,326,558	\$ 3,022
<i>Contributed surplus:</i>				
Balance, beginning of year		\$ 326		\$ 179
Fair value of stock options granted (note 13)		110		147
Balance, end of year		\$ 436		\$ 326
Total share capital		\$ 44,054		\$ 40,226

c) Accumulated other comprehensive income (loss):

Balance consists of:

(thousands of dollars)

	2010	2009
Net unrealized losses on assets held as available-for-sale ⁽¹⁾	\$ (6,376)	\$ (13,153)
Balance, end of year	\$ (6,376)	\$ (13,153)

⁽¹⁾ Net of income tax benefit of \$2,604 (2009-\$4,603).

PACIFIC & WESTERN CREDIT CORP.

Notes to Consolidated Financial Statements

Years ended October 31, 2010 and 2009

13. Stock-based compensation:

a) Stock options:

The Corporation has a stock option plan for its employees. Options are granted at an exercise price set at the closing market price of the Corporation's common shares on the day preceding the date on which the option is granted and are exercisable within ten years of issue. Options granted prior to September, 2000 vested immediately and options granted after September, 2000 typically vest over a two year period.

Options outstanding and options exercisable as of October 31, 2010 by range of exercise price are as follows:

Range of exercise prices	Options Outstanding			Options Exercisable	
	Number of stock options	Weighted-average remaining contractual life (years)	Weighted-average exercise price	Number of stock options	Weighted-average exercise price
\$3.00 - \$6.00	122,200	7.66	\$ 4.57	72,200	\$ 4.87
\$6.00 - \$9.00	261,148	6.98	7.59	241,148	7.47
\$9.00 - \$12.00	124,985	6.17	11.69	124,985	11.69

Stock option transactions during 2010 and 2009 are as follows:

	2010		2009	
	Number of options	Weighted-average exercise price	Number of options	Weighted-average exercise price
Outstanding, beginning of year	859,033	\$ 8.69	1,077,110	\$ 9.02
Granted	80,000	4.56	50,000	5.00
Exercised	—	—	—	—
Expired	(430,700)	8.89	(268,077)	9.33
Outstanding, end of year	508,333	\$ 7.87	859,033	\$ 8.69

PACIFIC & WESTERN CREDIT CORP.

Notes to Consolidated Financial Statements

Years ended October 31, 2010 and 2009

13. Stock-based compensation - continued:

a) Stock options - continued:

The fair value of options granted during the year was determined using the Black-Scholes option pricing model with the following weighted-average assumptions:

	2010	2009
Options granted	80,000	50,000
Exercise price per share	\$ 4.56	\$ 5.00
Risk-free interest rate	2.31%	2.41%
Dividend yield	0%	0%
Expected volatility	45%	45%
Expected option life	5 years	5 years
Expected forfeiture rate	5%	5%
Fair value per option	\$ 1.38	\$ 1.26

During the year ended October 31, 2010, the Corporation recognized \$110,000 (2009 - \$147,000) of compensation expense relating to options granted by the Corporation.

b) Deferred share units:

During the year ended October 31, 2010 the Corporation granted 42,083 (2009 - 49,080) deferred share units ("DSU"). Each DSU entitles the holder to a cash distribution equal to the closing market price of the Corporation's common shares upon retirement of the holder. During 2010, \$67,000 (2009 - \$48,000) was paid out relating to 18,196 DSUs. At October 31, 2010 there were 115,470 (2009 - 91,583) DSUs outstanding. For the year ended October 31, 2010, the Corporation recognized \$80,000 (2009 - \$130,000) of compensation expense relating to DSUs.

14. Other income (charges):

(thousands of dollars)

	2010	2009
Gain (loss) on assets held for trading	\$ (499)	\$ 1,025
Gain on real estate held for sale	267	626
Other income (charges)	(224)	94
Impairment writedown on securities	(326)	-
Mark-to-market adjustment for derivatives	246	(296)
Gains realized on securitization	1,348	-
Loss on sale of available-for-sale assets	(463)	-
	\$ 349	\$ 1,449

PACIFIC & WESTERN CREDIT CORP.

Notes to Consolidated Financial Statements

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15. Income taxes:

Income taxes, including both the current and future portions, vary from the amounts that would be computed by applying the statutory federal and provincial tax rates aggregating 31% (2009 – 32%) to income before income taxes. Income taxes have been computed as follows:

(thousands of dollars)

	2010	2009
Tax recovery at basic rates	\$ (2,559)	\$ (3,877)
Changes in taxes resulting from:		
Non-taxable income from securities	(1,088)	(1,232)
Non-taxable portion of capital gains	143	–
Other permanent differences	1,538	340
Tax rate differential	601	301
Valuation allowance	–	606
Benefit of losses not recognized	1,184	1,640
Income tax recovery	\$ (181)	\$ (2,222)
The income tax recovery is comprised of:		
Current income tax (recovery) provision	\$ –	\$ –
Future income tax recovery	(181)	(2,222)
	\$ (181)	\$ (2,222)

PACIFIC & WESTERN CREDIT CORP.

Notes to Consolidated Financial Statements

Years ended October 31, 2010 and 2009

15. Income taxes - continued:

The components of future income tax balances are as follows:

(thousands of dollars)

	2010	2009
		(restated – note 2)
Future income tax assets:		
Investments assets	\$ –	\$ 1,535
Allowance for credit losses	1,123	2,489
Loss carry-forwards	13,796	12,615
Other	128	589
	15,047	17,228
Less: Valuation allowance	(3,188)	(3,309)
	11,859	13,919
Future income tax liabilities:		
Capital assets	391	324
Deposit commissions	753	921
	1,144	1,245
Net future income tax asset	\$ 10,715	\$ 12,674

The Corporation's future income tax asset is represented primarily by income tax loss carry-forwards of the Bank which total \$38,894,000 (2009 – \$40,178,000) and expire in years from 2014 to 2029 if unutilized. A portion of the income tax loss carry-forwards relates to the decline in market value of the preferred shares, as described below which are deducted from income for income tax purposes.

The realization of the future 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 outstanding at October 31, 2010. Among other things, the ability to generate sufficient taxable income is dependent upon the Bank converting non-taxable income sources to taxable income sources during the carry-forward period and upon the Bank's continued ability and intent to hold the preferred shares until they recover in value or until they are redeemed as they are carried at market value for income tax purposes with mark to market adjustments being added to or deducted from taxable income. At October 31, 2010 the unrealized loss on preferred shares was (\$8,268,000) compared to (\$16,413,000) at October 31, 2009 (note 4(c)). While management is of the opinion that it is more likely than not that the Bank will be able to realize the future income tax asset, there is no guarantee the Bank will be able to generate sufficient taxable income during the carry-forward period from its existing level of capital. In this case, utilization of the income tax losses and deductible temporary differences may be dependent upon the Bank increasing its capital to facilitate growth in its treasury and loan portfolios.

PACIFIC & WESTERN CREDIT CORP.

Notes to Consolidated Financial Statements

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15. Income taxes - continued:

Loss carry-forwards of the Corporation and its subsidiaries will expire, if unused, as follows:

(thousands of dollars)

	Pacific & Western Credit Corp.	Pacific & Western Bank of Canada	Total
2014	\$ 1,076	\$ —	\$ 1,076
2017	—	1,867	1,867
2026	1,033	—	1,033
2027	—	5,966	5,966
2028	318	29,162	29,480
2029	6,277	1,899	8,176
2030	4,255	—	4,255
	\$ 12,959	\$ 38,894	\$ 51,853

16. Per share amounts:

Basic earnings (loss) per share

(thousands except per share amounts)

	2010	2009
Net loss	\$ (8,074)	\$ (9,895)
Less dividends on Class A preferred shares	(67)	(211)
Net income (loss) available to common shareholders	(8,141)	(10,106)
Average number of common shares outstanding	13,986	13,646
Basic earnings (loss) per share	\$ (0.58)	\$ (0.74)

Diluted earnings (loss) per share

(thousands except per share amounts)

	2010	2009
Net loss available to common shareholders	\$ (8,141)	\$ (10,106)
Average number of common shares outstanding	13,986	13,646
Dilutive effect of employee stock options	—	—
Dilutive effect of conversion of Class B preferred shares	—	—
Average number of common shares outstanding assuming dilution	13,986	13,646
Diluted earnings (loss) per share	\$ (0.58)	\$ (0.74)

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Notes to Consolidated Financial Statements

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16. Per share amounts – continued:

Employee stock options totalling 508,333 (2009 – 859,033) were excluded as the result would be anti-dilutive. The effect of converting 1,909,458 (2009 – 1,326,558) Class B preferred shares has also been excluded as the result would be anti-dilutive.

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Notes to Consolidated Financial Statements

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17. Derivative instruments:

As at October 31, 2010, the Corporation had outstanding contracts for Asset Liability Management purposes to hedge fair value exposure attributed to interest rate risk. The Corporation only enters into these interest rate contracts for its own account and does not act as an intermediary in this market. The credit risk is limited to the amount of any adverse change in interest rates applied to the notional amount in the contract should the counterparty default. Approved counterparties and maximum limits on notional amounts are established by corporate policy. At October 31, 2010, the counterparties to these agreements consisted of Canadian chartered banks.

At October 31, 2010, these contracts had notional amounts totalling \$209,060,000, of which \$184,243,000 qualified for hedge accounting with the remaining amounts relating to securitization activities as noted below. These contracts had an unfavorable fair value position of \$19,907,000 with this amount being included in Other Liabilities (note 10) and the offsetting amount included in the carrying values of the asset to which they relate. These contracts have a current replacement cost of \$261,200 with this amount being included in Other Assets (note 7), a credit equivalent amount of \$3,058,000, and a risk-weighted balance of \$612,000. At October 31, 2009, these contracts had notional amounts totalling \$263,128,000 all of which qualified for hedge accounting. These contracts had an unfavorable fair value position of \$17,887,000 and are recorded in Other Liabilities.

The current replacement cost represents the positive fair value for all contracts without taking into account any master netting or collateral arrangements that have been made. The current replacement cost does not reflect actual or expected losses. The credit equivalent amount is the current replacement cost plus an add-on for potential future exposure based on a formula prescribed in the Capital Adequacy Guideline of the Office of the Superintendent of Financial Institutions. The risk-weighted balance is the credit equivalent amount multiplied by counterparty risk factors prescribed by this Guideline.

In addition, the Corporation enters into interest rate swap arrangements with accredited counterparties in order to transact with the Canada Housing Trust, as it securitizes mortgages under the Canada Mortgage Bond Program. Changes in the fair values of these arrangements are included in gains on securitization activities and included in other income in the Consolidated Statements of Operations. Approved counterparties are limited to Canadian chartered banks. At October 31, 2010 the notional amount of these contracts totaled \$24,817,000.

The contracts mature as follows:

(thousands of dollars)

2011	\$	16,532
2012		5,298
2013		12,087
2014		—
2015		—
Thereafter		175,143

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18. Nature and extent of risks arising from financial instruments:

Risk management involves the identification, ongoing assessment, managing and monitoring of material risks that could adversely affect the Corporation. The Corporation is exposed to credit risk, liquidity risk, and market risks.

Senior management is responsible for establishing the framework for identifying risks and developing appropriate risk management policies and framework. The Corporation's Board of Directors, either directly or indirectly through its committees, reviews and approves corporate policies, including specific reporting procedures. This enables them to monitor ongoing compliance with policies, delegate limits and review management's assessment of risk in its major risk taking activities. An independent internal auditor is employed to provide a continuing review of policies and procedures to ensure they are appropriate, effective and being followed and that adequate controls are in place in order to mitigate risk to acceptable levels. The internal auditor reports directly to the Audit Committee of the Board of Directors. In addition, the Corporation has an ongoing compliance management program with a Compliance Officer who reports to the Board of Directors on a quarterly basis.

Credit Risk

Credit risk is the potential for loss due to the failure of a counterparty or borrower to meet its financial obligations. The Corporation manages its credit risk using policies that have been recommended by management to the Risk Review Committee, who 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 provides for risk rating each asset in its total asset portfolio, and early recognition of problem accounts (watch list accounts) with an action plan for each account. The Risk Review Committee reviews these policies on an ongoing basis. Additionally, credit risk is managed with an emphasis on lower risk assets that include public sector borrowers, investment grade corporations and well established commercial enterprises.

A Risk Review Committee comprised entirely of unrelated 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 they are prudent and appropriate given possible changes in market conditions and corporate strategy.
- Ensures that procedures and controls for managing credit risk are in place.
- Concurs with credits exceeding the levels delegated to management, prior to commitment.
- Reviews, on a regular basis, watch list accounts, impaired loans and accounts that have gone into arrears.

See note 4 for information relating to credit risk associated with securities and note 6 for information relating to credit risk associated with loans.

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Notes to Consolidated Financial Statements

Years ended October 31, 2010 and 2009

18. Nature and extent of risks arising from financial instruments – continued:

Liquidity Risk

Liquidity risk is the risk of the Corporation being unable to honour all cash outflow obligations as they come due. The Corporation 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. The Risk Review 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 loss resulting from changes in interest rates, foreign exchange rates, and market prices and volatilities that arise from the Corporation's funding and investment activities. The Corporation's principal risk arises from interest rate risk as the Corporation does not undertake foreign exchange or trading activities. The Risk Review Committee is charged with recommending policies that govern market risk to the 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, interest rate sensitivity gap and duration analysis and the use of interest rate swap agreements to assist in matching cash inflows and outflows. Management prepares regular reports to the Board to allow for ongoing monitoring of the Bank's interest rate risk position.

Management's Asset Liability Committee reviews the results of these analyses on a monthly basis and monitors compliance with limits set by corporate policy. The interest rate risk position and results of the Bank's duration analysis are presented in the table below.

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18. Nature and extent of risks arising from financial instruments – continued:

Interest Rate Position

(thousands of dollars)

	2010		2009	
	Increase 100 bps	Decrease 100 bps*	Increase 100 bps	Decrease 100 bps*
Maximum interest exposure during a 12 month period	\$ 3,441	n/m	\$ 1,884	n/m
Maximum interest exposure during a 60 month period	2,483	n/m	2,469	n/m
Duration difference between assets and liabilities (months)	0.6		2.2	

*n/m – not meaningful due to current level of market interest rates

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19. Interest rate risk:

The Corporation is exposed to interest rate risk as a consequence of the mismatch, or gap, between assets, liabilities and off-balance sheet instruments scheduled to mature or reset on particular dates. The gaps, which existed at October 31, are as follows:

	at earlier of maturity or reset date of interest rate sensitive instruments							
	Floating rate	Within 3 months	3 months to 1 year	1 year to 2 years	2 years to 5 years	Over 5 years	Non-interest rate sensitive	Total
(thousands of dollars)								
Assets								
Cash resources	\$ 39,445	\$ 57,544	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 96,989
Effective yield	1.00%	0.80%						
Securities	28,100	4,672	67,069	82,795	23,966	28,059	-	234,661
Effective yield	2.09%	1.83%	1.26%	3.52%	4.39%	4.03%		
Loans	264,064	38,952	38,509	111,725	264,833	247,553	(774)	964,862
Effective yield	4.82%	6.23%	5.59%	5.37%	5.61%	5.54%		
Other	-	-	-	-	-	-	26,220	26,220
Total assets	\$ 331,609	\$ 101,168	\$ 105,578	\$ 194,520	\$ 288,799	\$ 275,612	\$ 25,446	\$ 1,322,732
Liabilities								
Deposits	\$ 36,187	\$ 108,743	\$ 542,085	\$ 343,196	\$ 108,674	\$ -	\$ 12,018	\$ 1,150,903
Effective rate	1.05%	1.41%	2.15%	2.74%	3.46%			
Notes payable	-	-	4,942	-	-	70,617	-	75,559
Effective rate			7.77%			11.18%		
Other	-	-	-	-	-	-	38,396	38,396
Preferred share liabilities	-	-	-	-	-	40,744	-	40,744
Effective rate						11.80%		
Shareholders' equity	-	-	-	-	-	-	17,130	17,130
Total liabilities and shareholders' equity	\$ 36,187	\$ 108,743	\$ 547,027	\$ 343,196	\$ 108,674	\$ 111,361	\$ 67,544	\$ 1,322,732
On balance sheet gap	\$ 295,422	\$ (7,575)	\$ (441,449)	\$ (148,676)	\$ 180,125	\$ 164,251	\$ (42,098)	\$ -
Derivatives used for ALM	-	184,243	24,817	(21,830)	(12,087)	(175,143)	-	
Effective rate		2.14%	3.48%	5.08%	6.02%	5.16%		
2010 gap	\$ 295,422	\$ 176,668	\$ (416,632)	\$ (170,506)	\$ 168,038	\$ (10,892)	\$ (42,098)	\$ -
Cumulative 2010 gap	\$ 295,422	\$ 472,090	\$ 55,458	\$ (115,048)	\$ 52,990	\$ 42,098	\$ -	\$ -
2009 gap	\$ 357,115	\$ 74,639	\$ (551,323)	\$ (117,142)	\$ 268,305	\$ (8,682)	\$ (22,912)	\$ -
Cumulative 2009 gap	\$ 357,115	\$ 431,754	\$ (119,569)	\$ (236,711)	\$ 31,594	\$ 22,912	\$ -	\$ -

PACIFIC & WESTERN CREDIT CORP.

Notes to Consolidated Financial Statements

Years ended October 31, 2010 and 2009

19. Interest rate risk - continued:

Interest rate swap agreements to exchange interest terms are entered into for the purpose of limiting exposure to changes in interest rates. A positive interest rate gap exists when interest sensitive assets exceed interest sensitive liabilities for a specific maturity or repricing period. A positive gap will tend to lead to an increase in net interest income when market rates rise since assets are repricing earlier than liabilities. The opposite impact will occur when market interest rates fall.

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Years ended October 31, 2010 and 2009

20. Fair value of financial instruments:

The amounts set out in the table below represent the fair value of the Corporation's on and off-balance sheet financial instruments.

(thousands of dollars)

	2010			2009		
	Book Value	Fair value of assets and liabilities	Fair value over (under) book value	Book Value	Fair value of assets and liabilities	Fair value over (under) book value
Assets				(restated-note 2)	(restated-note 2)	(restated-note 2)
Cash resources	\$ 96,989	\$ 96,989	\$ --	\$ 172,297	\$ 172,297	\$ --
Securities	234,661	234,661	--	271,660	270,333	(1,327)
Loans	964,862	962,832	(2,030)	929,831	928,176	(1,655)
Other financial assets	2,075	2,075	--	7,620	7,620	--
	\$ 1,298,587	\$ 1,296,557	\$ (2,030)	\$ 1,381,408	\$ 1,378,426	\$ (2,982)
Liabilities						
Deposits	\$ 1,150,903	\$ 1,116,428	\$ (34,475)	\$ 1,217,136	\$ 1,206,181	\$ (10,955)
Notes payable	75,559	83,111	7,552	77,933	80,324	2,391
Other financial liabilities	38,396	38,396	--	71,293	71,293	--
Preferred share liability	40,744	45,827	5,083	27,892	33,695	5,803
	\$ 1,305,602	\$ 1,283,762	\$ (21,840)	\$ 1,394,254	\$ 1,391,493	\$ (2,761)
Total			\$ 19,810			\$ (221)

The fair value amounts have been determined using the valuation method and assumptions described below:

- The fair values of securities and other financial assets are determined based on quoted market prices and internal and external valuation models that incorporate observable market data such as interest rates and credit spreads.
- The fair value of loans is based on net discounted cash flows using market interest rates for loans and appraised values for real estate.
- The fair value of deposits is determined based on discounted cash flows using market interest rates.
- The fair value of notes payable and Class B Preferred Shares are determined by referring to current trading values.
- The fair value of other financing obligations is approximately equal to their book value due to the short-term nature of the instruments.
- The fair value of ALM derivatives is derived from the use of cash flow modeling techniques.

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Notes to Consolidated Financial Statements

Years ended October 31, 2010 and 2009

21. Segmented information:

The operations of the Corporation consist primarily of one business segment (Banking) which provides lending services to corporate and public sector markets and deposit services to retail depositors through a well diversified broker network.

22. Commitments and contingencies:

a) Credit commitments:

The amounts of credit related commitments represents the maximum amount of additional credit that the Corporation could be obliged to extend. Under certain circumstances, the Corporation may cancel loan commitments at its option. The amounts with respect to letters of credit are not necessarily indicative of credit risk as many of these arrangements are contracted for a limited period of usually less than one year and will expire or terminate without being drawn upon.

(thousands of dollars)

	2010	2009
Loan commitments	\$ 236,003	\$ 109,378
Letters of credit	26,731	30,133
	\$ 262,734	\$ 139,511

b) Lease commitments:

The Corporation has obligations under leases for rental of premises. Minimum future lease commitments for each of the five succeeding years and thereafter are as follows:

(thousands of dollars)

2011	\$	702
2012		613
2013		613
2014		377
2015		263
Thereafter		—

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Years ended October 31, 2010 and 2009

22. Commitments and contingencies - continued:

c) Legal proceedings:

In the ordinary course of business, there are actions pending against the Corporation and its subsidiaries. Management of the Corporation believes that the resolution of outstanding actions will not be material to the financial position of the Corporation or the outcome is not determinable at this time.

d) Pledged assets:

In the ordinary course of business, cash and securities are pledged against liabilities and off-balance sheet items.

Details of assets pledged are as follows:

(thousands of dollars)

	2010	2009
Obligations related to securities sold under repurchase agreements (note 10)	\$ —	\$ 46,578
Collateral related to derivative transactions	19,367	14,271
Collateral related to letters of credit	5,111	2,940
	\$ 24,478	\$ 63,789

23. Related party transactions:

At October 31, 2010, the Corporation had loans to officers and directors totalling \$2,924,000 (2009 - \$3,786,000).

24. Capital management:

a) Overview:

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

The Corporation's primary subsidiary is Pacific & Western Bank of Canada, (the "Bank") and as a result, the following discussion on capital management is with respect to the capital of the Bank. The Bank operates as a bank under the *Bank Act* (Canada) and is regulated by the Office of the Superintendent of Financial Institutions Canada (OSFI). OSFI sets and monitors capital requirements for the Bank.

PACIFIC & WESTERN CREDIT CORP.

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Years ended October 31, 2010 and 2009

24. Capital management – continued:

Capital is managed in accordance with policies and plans that are regularly reviewed and approved by the Board of Directors and take in to account forecasted capital needs and markets.

The goal is to maintain adequate regulatory capital to be considered well capitalized, protect consumer deposits and provide capacity for internally generated growth and strategic opportunities that do not otherwise require accessing the public capital markets, all the while providing a satisfactory return to shareholders. The Bank's regulatory capital is comprised of share capital, retained earnings and unrealized gains (losses) on available-for-sale equity securities (Tier 1 capital) and the face value of subordinated notes (Tier 2 capital).

The Bank monitors its capital adequacy and related capital ratios on a daily basis and has policies setting internal maximum and minimum amounts for its capital ratios. These capital ratios consist of the assets-to-capital multiple and the risk-based capital ratio.

During the year ended October 31, 2010, there have been no material changes in the Bank's management of capital.

b) Assets-to-Capital Multiple:

The Bank's growth in total assets is limited by a permitted assets-to-capital multiple which is prescribed by OSFI and is defined as the ratio of the total assets of the Bank to its regulatory capital. The Bank's assets-to-capital multiple is calculated as follows:

(thousands of dollars)	2010	2009
		(restated – note 2)
Total assets (on and off-balance sheet)	\$ 1,342,619	\$ 1,438,207
Capital		
Common shares	\$ 95,365	\$ 95,365
Retained earnings (deficit)	(897)	(1,364)
Unrealized loss on available-for-sale equity securities	(6,786)	(12,822)
Subordinated notes	41,500	40,590
Total regulatory capital	\$ 129,182	\$ 121,769
Assets-to-capital ratio	10.39	11.81

For a period of time during the quarter ended January 31, 2009, the Bank estimated that it had on a temporary basis exceeded, by a minor amount, the assets-to-capital ratio that had been established by OSFI. This exception took place primarily as a result of a decrease in the market value of preferred shares held in the Bank's securities portfolio and which are primarily those of major Canadian banks and insurance companies. This decrease took place as a result of market volatility versus any credit impairment in the issuers of the securities. In January 2009, the Bank's adherence to this requirement was re-established and has been adhered to since that date.

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Notes to Consolidated Financial Statements

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24. Capital management – continued:

c) Risk-Based Capital Ratio:

OSFI requires banks to measure capital adequacy in accordance with guidelines for determining risk adjusted capital and risk-weighted assets including off-balance sheet credit instruments. Based on the deemed credit risk for each type of asset, a weighting of 0% to 150% is assigned to determine the risk-based capital ratio. OSFI recommends that banks maintain a minimum total risk-based capital ratio in excess of 10% and a Tier 1 risk-based capital ratio in excess of 7%.

In June 2004, the Basel Committee on Banking Supervision released its report entitled "International Convergence of Capital Measurement and Capital Standards: A Revised Framework" (Basel II). The new framework is designed to more closely align regulatory capital requirements with underlying risks by introducing changes in the treatment of credit risk. An explicit new capital charge for operational risk was introduced, as well as increased supervisory review of capital adequacy and expansion of the related public disclosure. The new Basel II Framework was effective November 1, 2007 for Canadian banks.

In September 2010, the Basel Committee on Banking Supervision released further revisions to the above framework (Basel III). The revisions include regulatory requirements for additional capital buffers, new definitions of regulatory capital and liquidity among other things. Implementation of the Basel III requirements is not expected to commence until 2013. The impact upon the Bank is not determinable at this time.

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

(thousands of dollars)	2010		2009	
	Notional Drawn Amount	Risk Weighted Balance	Notional Drawn Amount	Risk Weighted Balance
			(restated- note 2)	(restated- note 2)
Balance sheet assets	\$ 1,315,888	\$ 837,361	\$ 1,407,855	\$ 845,879
Off-balance sheet assets	495,921	117,623	402,639	63,477
Charge for operational risk		10,732		11,388
Total risk-weighted assets		\$ 965,716		\$ 920,744
Regulatory capital		129,182		121,769
Total risk-based capital ratio		13.38%		13.23%
Tier 1 risk-based capital ratio		9.08%		8.82%

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Notes to Consolidated Financial Statements

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25. Subsidiary company information:

The following table presents summary financial information regarding the Bank on a consolidated basis:

Consolidated balance sheets

<i>(thousands of dollars)</i>	2010	2009 (restated-note 2)
Cash and cash equivalents	\$ 88,991	\$ 170,650
Securities	234,661	271,660
Loans, net of allowance for credit losses	964,862	929,831
Other assets	27,374	35,714
	\$ 1,315,888	\$ 1,407,855
Deposits	\$ 1,150,903	\$ 1,217,136
Subordinated notes payable	40,025	39,946
Other liabilities	36,868	69,925
	1,227,796	1,327,007
Share capital	95,365	95,365
Retained earnings	(897)	(1,364)
Accumulated other comprehensive income (loss)	(6,376)	(13,153)
Shareholder's equity	88,092	80,848
	\$ 1,315,888	\$ 1,407,855

Consolidated statement of operations

<i>(thousands of dollars)</i>	2010	2009
Interest income	\$ 62,003	\$ 78,984
Interest expense	46,316	68,502
Net interest income	15,687	10,482
Provision for (recovery of) credit losses (note 6 (b))	(1,163)	3,449
Net interest income after provision for credit losses	16,850	7,033
Other income (charges)	286	1,449
Net interest income and other income (charges)	17,136	8,482
Non-interest expense	16,850	14,630
Loss before income taxes	286	(6,148)
Income taxes	(181)	(2,223)
Net income (loss)	\$ 467	\$ (3,925)

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Notes to Consolidated Financial Statements

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26. Comparative figures:

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