INDUSTRIAL ALLIANCE TRUST INC.

Basel Pillar Three Disclosure as of September 30, 2013

Introduction

Industrial Alliance Trust Inc. ("IA Trust" or "the company") is a trust and loan company subject to the *Trust and Loan Companies Act (Canada)*. IA Trust was initially a provincial charter company; it became a federal charter company in March 2005 and its main supervisory authority is the Office of the Superintendent of Financial Institutions ("OSFI"). It is a wholly-owned subsidiary of Industrial Alliance Insurance and Financial Services Inc. ("IAIFS"), a life and health insurance company that engages in business throughout Canada, as well as in the United States. IAIFS is listed on the Toronto Stock Exchange under the symbol IAG. IA Trust does not hold or control any subsidiary and the results presented for the company have not been consolidated with other entities.

IA Trust's primary activities are distributing deposit products through demand deposits and guaranteed interest deposits with a 1- to 5-year term and issuing vehicle loans. IA Trust also acts as the trustee for registered products for Industrial Alliance group companies. In this respect, it sometimes acts as a deposit-taking institution for sums held in cash in the accounts of clients for whom it is the trustee in the form of demand deposits.

The company has established an investment policy and a matching policy to monitor the deposits received and the loans issued. Thus, the company has put measures in place to manage the credit risk and structural interest rate risk of the portfolio. Cash management is subject to daily monitoring in order to support liquidity risk management. The company has very low market risk exposure and is in no way exposed to foreign exchange risk. It is also of the view that it is not exposed to counterparty risk because the assets held are of good quality; thus, the vast majority of the assets in the form of bonds are government bonds.

This document is designed to meet the disclosure requirements set by the OSFI pursuant to the proceedings of the Basel Committee on Banking Supervision. This disclosure is done according to the requirements of the third pillar of the Basel agreements.

Capital

As mentioned, IA Trust is a wholly-owned subsidiary of IAIFS. Its capital consists primarily of two sources. The first is the share capital issued by the company, held by IAIFS. The second source corresponds to the company's retained earnings. Thus the company's capital consists solely of tier 1 capital; the company does not have any tier 2 capital such as preferred shares or subordinated debts. In the rest of the document, no distinction will be made between types of capital. We will refer only to total capital which corresponds to tier 1 capital for the company's specific situation.

The company's capital (in millions of $) determined according to Basel III requirements is:

	2013-09-30	2012-12-31
Share capital	10.0	10.0
Retained earnings	8.8	9.0
Other capital components	0.9	1.5
Total – Capital	19.7	20.5

To manage its capital, IA Trust has put the following measures in place. Firstly, the company carries out an annual Internal Capital Adequacy Assessment Process (ICAAP) as required by OSFI. The ICAAP is designed to determine the level of capital required by the company based on its risk profile. The ICAAP is prepared by the company's senior management and presented to the board of directors for approval. The ICAAP serves as the basis for establishing the regulatory capital management framework. The framework is approved annually by the board of directors. The regulatory capital management framework has the following objectives:

- to set the minimum and maximum amounts and the target for capital. The minimum, maximum and target are set according to the ICAAP results and regulatory limits corresponding to the asset-to-capital ratio and the risk-based capital ratio.
- to file with the board of directors a quarterly report on the company's capital development, including a capital projection based on anticipated events for the coming quarters.
- to define actions to be taken based on projections in order to maintain capital within the designated benchmarks (maximum and minimum).

With respect to calculations for determining the risk-based capital ratio based on the capital adequacy requirements set by the OSFI, the company has made the following choices:

i. For credit risk, the company has chosen to take the standard approach. Thus, IA Trust uses evaluations made by credit rating organizations to determine risk weighting factors. This approach was preferred to that based on internal ratings. Note that the company does not take part in securitization activities.

ii. For operational risk, the company has chosen to take the "basic indicator" approach. With this approach, risk assessment is performed by applying a formula based on the annual gross income of the past three years.

iii. For market risk, the company is not of the size to require the application of the formula prescribed by capital adequacy requirements for market risk.

The results for the company's capital ratios are given below. Note that the OSFI's requirement for the company is 7.0% for the risk-based capital ratio (tier 1 capital). This ratio will be 10.5% for total capital beginning in 2014.

Ratios	2013-09-30	2012-12-31
• Asset-to-capital	9.18	6.67
• Risk-based capital ratio	30.82 %	58.24 %

Taking into account existing capital adequacy requirements which are 7.0% for the risk-based capital ratio, the level of capital required according to capital adequacy requirements for credit risk, operational risk and market risk are (in millions of $):

Capital requirements	2013-09-30	2012-12-31
• Credit risk	4.1	2.1
• Operational risk	0.4	0.3
• Market risk	0	0

Risk Management

Credit risk

Credit risk management takes place in two areas, namely, investments and loans:

Investments

Investments correspond to the assets held in the form of short-term securities, bonds and preferred shares. The company's investment policy establishes the principles for credit risk management. Credit risk management is based on a prudent approach. The company is not authorized to participate in private issues of securities.

Similarly, the company uses the credit ratings established by a recognized credit agency and has a policy of not acquiring debt securities of a quality below BBB (low) or preferred shares below P-1 and P-2. The methodology for establishing credit ratings of debt securities is as follows: first, DBRS ratings are used. In the event that this agency has not established a rating for a security, we use, in this order, ratings from Standard & Poor's and Moody's. If the security has not been rated by these three agencies, we perform an internal evaluation of the security's credit.

In order to adequately manage credit risk, the investment policy also calls for diversification measures by asset class as well as criteria for diversification within each asset class (limit by category of issuer, by type of issue, by credit rating, by issuer, according to weight within S&P/TSX, and by S&P/TSX sector).

Therefore, as of December 31, 2012, holdings show a prudent approach in order to manage credit risks:

- Short term — 100% in securities issued by the provinces or the Government of Canada with R-1 (high) and R-1 (middle) ratings.
- Bonds — 90.5% of the portfolio consists of securities issued by the Government of Canada, issued by a province, or guaranteed or made by a province.
- Preferred shares — Detained shares are rated P1 and P2 and are found solely in the "Banks, utilities and pipeline" group.

As of December 31, 2012, the company had no security in default or under surveillance in its portfolio.

Loans

The company has consumer loan activities in the form of mortgage loans and vehicle loans. With regard to mortgage loans, the company ceased to acquire new loans in late-2012, preferring to concentrate on vehicle lending. The mortgage loans in the portfolio consist of residential loans acquired under an agreement with the parent company, Industrial Alliance Insurance and Financial Services Inc., which evaluates credit. Any loan that has a loan-to-value ratio that exceeds 80% is insured. The equivalent of 97.0% of the loans in effect is insured by CMHC or a private insurer. As of December 31, 2012, the company had no outstanding mortgage loans in its portfolio.

The company established a consumer lending operation (indirect vehicle financing). The financing is provided in collaboration with a network of company-certified auto dealers. The company holds a security interest in the vehicle acquired by the borrower. The credit risk is managed through the implementation of proper procedures concerning the evaluation of the client's credit, the establishment of loan acceptance benchmarks and client follow-up in case of failure to make payments. Approval limits have been established. The maximum limit for vehicle financing is $150,000. Also, a limit of $250,000 per client for all loans with the company is set. Loans are issued at the "regular rate"; the company does not issue loans at the "premium rate." We are monitoring outstanding loans in order to reduce occasional losses incurred by loans in default and to be able to adequately exercise our rights to the security. The company maintains collective provisions for losses that are anticipated though not yet identified in our lending portfolio. It also maintains specific provisions for loans identified by management as being in default.

Market risk

The company is of the view that it has very limited exposure to market risk, as it has little exposure to the stock market. As of December 31, 2012, the company had a total of $3.7M (i.e. almost 2.7% of its total assets) in preferred shares. Therefore, stock market declines do not pose a significant risk for the company. Note that the company sold these securities in the first quarter of 2013 and is not exposed to risk through this type of investment. The company deems that it is not exposed to foreign exchange risk, as these investments are in Canadian dollars. Also, the company is not indirectly exposed by holding derivatives. Note that the investment policy stipulates that the company may acquire derivatives in order to offset the risk associated with interest rate fluctuations; the company currently has no derivatives.

Liquidity risk

Risk related to financing is essentially managed by the daily management of cash flow, by maintaining a close match between the financial structure of assets and commitments for term deposits, as well as by maintaining a high level of quality and negotiability of the securities in the portfolio.

Note that the investment policy in effect provides measures for the diversification of investment vehicles in order to protect the company from liquidity risk. Therefore, with the exception of Government of Canada securities or provincial securities, the company has set a limit per issuer. The following securities are used:

- short-term investment (excellent liquidity);
- bonds (higher level of liquidity, given the focus on government securities);
- mortgage and vehicle loans (low level of liquidity).

In sum, the company's strategy applies as follows:

a. Matching asset and liability cash flows in order to plan term deposit needs
b. Maintaining a money market percentage for each matching block (cash and short-term securities). A higher percentage is used for demand deposit matching blocks than for term deposits
c. Presence of negotiable securities in each matching block, with the exception of the block corresponding to guaranteed deposit certificates (term deposits).
d. Access to two lines of credit for emergency financing:
    i. line of credit with a Canadian bank
    ii. line of credit with the parent company, IAIFS.
e. Presence of negotiable securities for assets invested from capital. The investment policy provides a target whereby most bond securities are provincial government securities and securities that are guarantee by provincial governments.

Risk from banking portfolio structural interest rate

For the company, this risk corresponds to the risk of non-matching of cash flows. The risk of non-matching is primarily present for term deposit products issued by IA Trust. In order to manage this risk, the company uses an immunization approach to market risk by setting up a process for matching cash flows from assets and liabilities. Therefore, the company's investment policy includes a match policy that is at the base of the investment strategy for term deposit liabilities. The manager gives a report on cash flow matching at each investment committee meeting.

To quantify the risk of structural interest rate in the banking portfolio, the investment committee report on changes in the portfolio value is done on more than one scenario of various movements in the interest curve. The calculation is done by taking into account both demand deposits and term deposits. The result of the various scenarios shows that the match strategy in effect helps to adequately determine the structural interest rate risk in the banking portfolio.

The December 31, 2012 report showed that the worst-case scenario was an increase in interest rates combined with a flattening of the curve, which means that the short-term rates increase more than the long-term rates. Therefore, the loss incurred in such a scenario would be 21 bps caused by a greater drop in assets than in deposits. The worst-case scenario is based on a presumed interest rate variation of:

Term (month)	1	2	6	12	24	36	48	60	84
Rate variation (scenario)	+0.50	+0.50	+0.40	+0.40	+0.40	+0.30	+0.30	+0.30	+0.20

Management also calculated the effect of a variation in interest rates of 100 basis points on the company's financial statements. This variation would lead to a variation of $1,385,619 in overall earnings and $43,878 in net earnings in 2012 ($2,632,177 in the overall earnings and $20,951 in the net earnings in 2011). Sensitivity was determined based on a variation in the fair value of financial instruments carried at fair value. This shows the effect on the financial statements, but does not take into account the impact of matching in order to mitigate the effect of a variation in interest rates. For example, the variation in net earnings only shows the variation in the market value of an asset on the balance sheet and the company's statement of earnings: liabilities are evaluated at the book value of deposits and this value does not fluctuate due to a variation in interest rates. With the matching strategy, this asset would most likely be held to maturity to allow these cash flows to cover the flows in liabilities.

Concentration risk

Within the investment policy, the company has set up diversification measures to weight each asset class within benchmarks that establish the weight of each type of security based on its quality (credit rating) and a maximum per issuer. Therefore, with the exception of government issuers or issuers that benefit from an equivalent direct or indirect guarantee, the policy sets limits on the concentration of direct or guaranteed investments by a single borrower or related borrowers.

Similarly, in order to reduce risk and diversify the portfolio of corporate securities, the company has established limits for this portfolio regarding maximum exposure in a given sector.

With regard to consumer loans, we have established a $250,000 limit for loans that can be held by a single client. Also, we have set limits for loans issued through a single automobile dealer.

Operational risk

This risk is related to business processes as well as legal and regulatory compliance issues. The risk of business processes refers to the risk of loss that may result from internal processes, people or systems that are inadequate or at fault, or external events. The risk of legal and regulatory compliance stems from the failure to abide by laws, regulations or directives governing the company as well as the risk of loss resulting in failure to conform to a contract.

In order to mitigate this risk, the company has implemented internal control procedures as well as a variety of policies and procedures to properly manage the company's business. These policies include an employee code of professional conduct and policies on how to process complaints and settle disputes. The company therefore benefits from the expertise of a parent company in various fields, including legal services, human resource management and IT services. Internal control is carried out by the internal auditing department of IAIFS, which carries out this function for all the companies in the IA group.

Other factors

The company is of the view that it is not exposed to counterparty credit risk. Also, the company does not engage in the securitization of its loan portfolio. All loans are maintained in the company's balance sheet until their maturity or their early repayment.

Compensation practices

The company's senior managers include all directors and senior management executives (president, vice-president, general manager and chief financial officer). The company does not have a separate compensation committee or the necessary resources to implement a functional plan for deferred compensation and performance-based compensation.

The president is a senior manager of the company's only shareholder, Industrial Alliance Insurance and Financial Services Inc. ("IAIFS"). He is paid directly by IAIFS, based on criteria established by IAIFS from time to time; a set amount that is determined annually and corresponds to a portion of the president's total compensation is paid by the company to IAIFS. IAIFS also pays the annual bonus to the president; however, the composition of the bonus is not important to parties other than the sole shareholder. The president's total compensation is, however, approximately the same amount as that of a key executive position in other major financial institutions. The vice-president, general manager and chief financial officer are paid a base salary and an annual discretionary bonus to align their overall compensation with that of similar positions in the industry according to the evaluation of their position. This evaluation is based on their experience and responsibilities.

Independent directors receive annual compensation, plus a stipend for each meeting they attend. The four independent directors received a total of $50,100 in 2012.

The compensation of key management personnel for the year was as follows:

	2012	2011
Salaries, professional fees and other short-term benefits	$561,640	$304,072
Total compensation of key management personnel	$632,176	$361,819