

Financial Well-being



Management Discussion and Analysis

2017
Annual Report

conexus
Credit Union

Management Discussion and Analysis

This Management Discussion and Analysis (MD&A) enables readers to assess material changes in the financial condition and operating results of Conexus Credit Union (Conexus) for the year ending on December 31, 2017 compared with the prior year and planned results. This MD&A is prepared in conjunction with the Consolidated Financial Statements and related Notes for the year ending December 31, 2017, and should be read together with those documents. The MD&A includes information up to February 23, 2018. Unless otherwise indicated, all amounts are expressed in Canadian dollars. Amounts for 2013, 2014, 2015, 2016 and 2017 have been primarily derived from Conexus' annual Consolidated Financial Statements, prepared in accordance with International Financial Reporting Standards (IFRS).

The following items provide an overview of topics discussed throughout the MD&A:

Economic Conditions

- 2017 economic and financial services conditions
- Economic and financial outlook for 2018

Financial Performance to Plan

- Financial management

Financial Position Review

- Overview
- Credit quality
- Liquidity management
- Capital management

Financial Performance Review

- Profitability
- Efficiency

Enterprise Risk Management

- Overview
- Risk governance
- Risk identification, measurement and assessment
- Risk monitoring and reporting
- Risk control and mitigation
- Significant risk areas

Caution Regarding Forward-looking Statements

This MD&A might contain forward-looking statements concerning future strategies of Conexus. These statements involve uncertainties in relation to prevailing economic, legislative, and regulatory conditions at the time of writing. Therefore, actual results may differ from the forward-looking statements contained in this discussion.

Factors That Might Affect Future Results

Although Conexus is focused in Saskatchewan, the economic and business conditions in Canada and abroad can affect the trading areas of Conexus and its financial position. Global economic conditions can influence Canada and local economies, affecting businesses, consumer prices and personal incomes. The prevailing conditions nationally can have an affect on financial markets and the Bank of Canada's monetary policy, causing changes in interest rates and the value of the Canadian dollar. Fluctuations in the capital markets and the extent of local competition can impact the market share and price of Conexus' products and services. All these factors affect the environmental conditions in which Conexus operates and, accordingly, Conexus' performance.

Economic Conditions

2017 Economic and Financial Services Conditions

In 2017 the global economy continued to experience positive growth. The global economy is forecasted to have grown 3.0% in 2017, up from 2.4% in 2016. Eurozone indicators remain positive and growth in the United States (U.S.) has improved throughout 2017.

The U.S. economy had a strong year of growth. Real GDP slowed in the fourth quarter but still came in at 2.3% year over year for 2017. Consumer spending, which accounts for more than two-thirds of U.S. economic activity, advanced at 5.4% year-over-year as consumer sentiment increased over the course of the year. The unemployment rate steadily declined throughout 2017 and ended the year at 4.1%, the lowest in forty years. Steady job growth, rising house prices, and a decreasing regulatory environment are helping support the U.S. economy. Against a positive economic backdrop toward the end of the year, the U.S. Federal Reserve decided to increase the federal funds rate for a third time.

The Canadian economy is forecast to have grown 3.0% in 2017, which is up from 1.3% in 2016. Overall housing prices rose 9.1%, exports have stabilized and the economy did so well, it forced the Bank of Canada to raise rates twice during the year. Headline inflation averaged 1.6% throughout 2017, and the Bank of Canada's core measure was 1.1% on average. Both measures fell within the Bank's target range of 1.0% to 3.0% and trended downward throughout the year. The unemployment rate also trended down to 5.7% over the course of the year. The

strengthening U.S. economy and the expectation of stronger global economic growth were offset by increased uncertainty about the North American Free Trade Agreement (NAFTA) and a stronger Canadian dollar.

It is estimated that Saskatchewan's economy grew 2.1% in 2017. Growth in 2017 was supported by slightly higher commodity prices throughout the year, a surprisingly good harvest and rising farm incomes. Despite these positive economy indicators, the health of the province's labour market stayed poor as unemployment came in at 6.4%, the second highest rate outside the Maritimes. On the retail sales front, growth increased 3.8% compared to 2.2% last year.

Yields on government bonds in Canada increased during 2017 due to increased economic growth and inflation expectations. Short-term interest rates increased as the Bank of Canada increased the overnight rate twice in 2017. It is expected that the Bank of Canada will continue to increase the overnight rate throughout 2018 due to continued economic growth and global economic strength.

Economic and Financial Outlook for 2018

The outlook for the global economy is expected to improve in 2018 with growth projected at 3.9%. Current economic conditions suggest that the U.S. will lead advanced economies in 2018 with growth forecast at 2.7%. The U.S. Federal Reserve is expected to raise rates three times in 2018 due to the improving economy and rising inflation as a result of new presidential policies.

The Bank of Canada increased the overnight rate in January 2018 due to continued economic growth. The Bank of Canada forecasts the Canadian economy to grow 2.2% in 2018. These forecasts were revised upward given the increased growth outlook for the U.S. economy and increased government spending and consumption in Canada. Many economists are forecasting the Bank of Canada to raise the overnight rate at least two more times in 2018. However, uncertainty surrounding the future of NAFTA is weighing on the Bank of Canada's forecast.

Saskatchewan's economy is expected to grow from an estimated 2.1% in 2017 to 2.7% in 2018. Saskatchewan's economic growth is expected to lead Canada as commodity prices recover, agriculture continues to be strong, and consumer confidence rebounds. Overall, Saskatchewan's economy is expected to do better in 2018 than 2016 and 2017.

Financial Performance to Plan

Each year, Conexus develops a corporate plan through a comprehensive budget and planning process. The following table provides an overview of key financial measures compared to 2017 plan. Actual results for 2017, 2016, 2015, 2014 and 2013 have also been included for comparison:

Financial Management

<i>(In thousands of CDN \$)</i>	2017 Actual	2017 Plan	2016 Actual	2015 Actual	2014 Actual	2013 Actual
Growth						
Assets	5,818,734	5,970,107	5,568,186	5,442,574	5,088,252	4,697,919
Asset growth	4.50%	7.22%	2.31%	6.96%	8.31%	11.80%
Deposits	4,325,176	4,434,396	4,195,923	4,091,499	3,936,830	3,847,137
Deposit growth	3.08%	6.03%	2.55%	3.93%	2.33%	8.93%
Loans and advances	4,948,361	4,973,775	4,668,855	4,488,575	4,334,073	3,961,710
Loans and advances growth	5.99%	6.53%	4.02%	3.56%	9.40%	14.34%
Credit quality						
Delinquency greater than 90 days	0.98%	0.97%	0.37%	0.18%	0.20%	0.45%
Net impaired loans and advances	45,963	50,491	15,214	7,151	6,219	8,635
Allowance for credit losses	8,756	4,359	3,270	3,104	4,282	11,425
Loan impairment charges	9,929	4,686	3,449	3,269	4,268	4,419
Liquidity management						
Liquid assets *	740,538	830,265	794,531	816,651	612,636	598,264
Investment securities	650,669	808,611	679,229	687,505	619,955	548,911
Liquid assets as a % of total assets	12.73%	13.91%	14.27%	15.00%	12.04%	12.73%
Capital management						
Risk-weighted capital	13.58%	13.44%	13.50%	13.51%	12.97%	11.88%
Common equity tier 1 capital to risk-weighted assets	12.94%	12.82%	12.80%	12.11%	11.45%	10.91%
Leverage ratio	8.02%	7.66%	7.79%	7.68%	7.55%	7.10%
Total capital **	484,083	477,730	454,035	417,757	388,731	358,038
Profitability and member return						
Total comprehensive income for the year	31,849	25,320	38,295	31,052	32,096	29,178
Return on assets (ROA) before tax allocations	0.75%	0.72%	0.88%	0.69%	0.75%	0.78%
Efficiency ratio	71.01%	78.88%	71.34%	75.60%	74.47%	74.17%

* Liquid assets include cash and cash equivalents, marketable investment securities, liquid investment securities held with Concentra and statutory liquidity investment securities at SaskCentral.

** Total capital of Conexus consists of amounts held in membership shares and member equity accounts (\$20.74 million in 2017); accumulated other comprehensive income (-\$1.91 million in 2017); and retained earnings (\$465.25 million in 2017). This differs from the definition of total capital used by the Credit Union Deposit Guarantee Corporation which amounts to \$482,172 (2016 - \$450,359).

Financial Position Review

The financial position review provides an analysis of our major balance sheet categories and a review of our deposits, loans and advances, liquidity, and capital positions. The review is based on the consolidated financial statements.

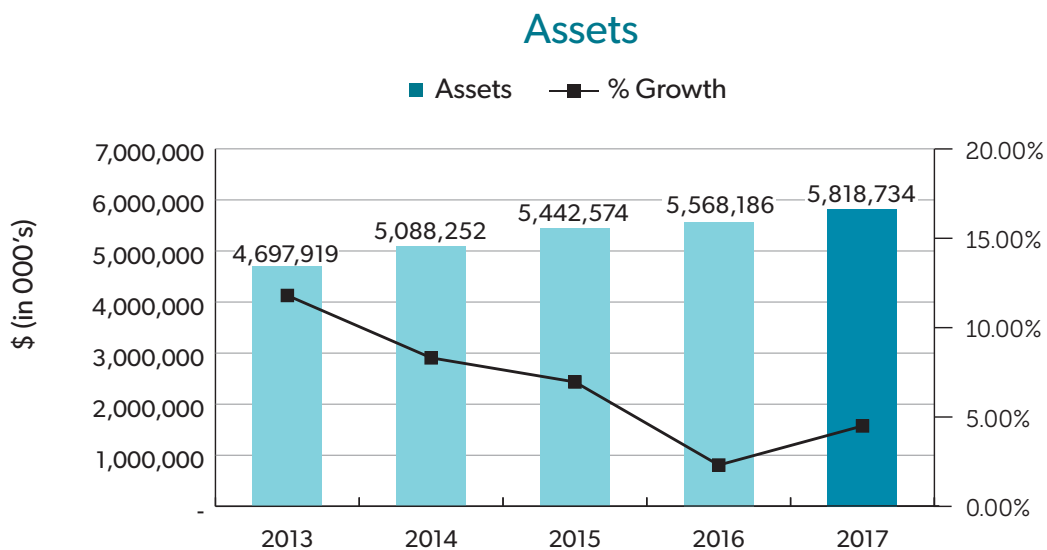
Overview

Total funds under management ended 2017 at \$7.88 billion, up from \$7.39 billion in 2016 and achieving total growth of 6.61%. Other funds under management, or "off-balance sheet" assets under administration, include: \$1.42 billion in wealth management assets, up from \$1.19 billion in 2016 or an increase of 19.36%; and \$645.90 million in syndicated loans and advances, an increase of 2.76% over 2016 levels of \$628.56 million.

Assets

"On-balance sheet" assets ended 2017 at \$5.82 billion, compared to \$5.57 billion in 2016, which represented growth of 4.50%. On balance sheet growth increased in 2017 due to an increase in loan demand.

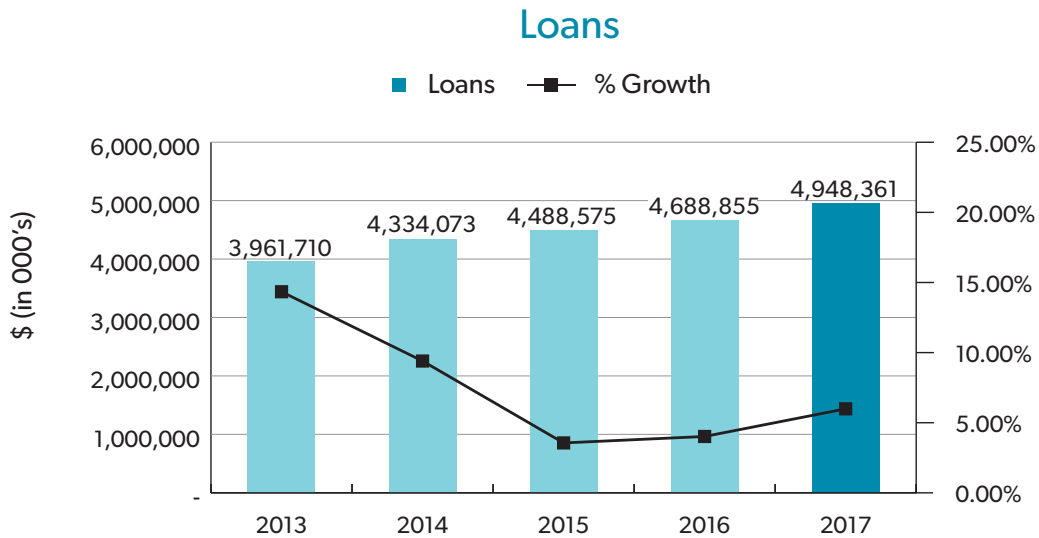
The following illustrates the Credit Union's growth in "on-balance sheet" assets over the past five years.



The following illustrates Conexus' loans and advances growth over the last five years.

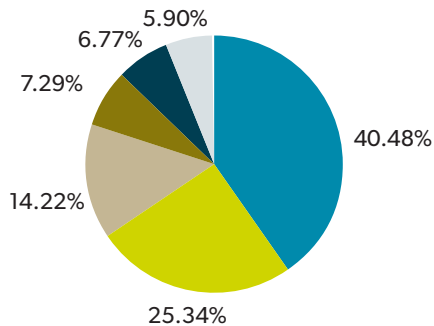
Loans and advances (loans)

Loans accounted for 85.04% of total assets, and amounted to \$4.95 billion as of December 31, 2017, representing an increase of 5.99% over the previous year's balance of \$4.67 billion.

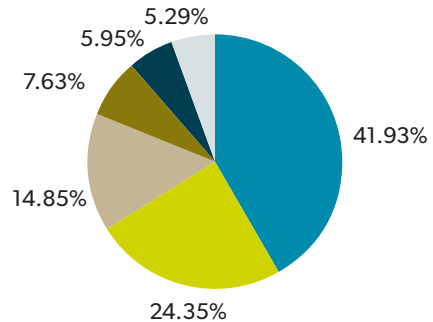


A significant portion of Conexus' loan portfolio continues to consist of stable, low-risk consumer mortgages. Loan allocation, expressed as a percentage of the total loan portfolio, to the consumer mortgage sector decreased from 41.93% in the previous year to end 2017 at 40.48%. Loan allocation to the commercial sector increased from the previous year, being 32.63% in 2017 compared to 31.98% in 2016. The agriculture sector increased slightly compared to the previous year, ending 2017 at 12.67%.

2017 Loan Portfolio



2016 Loan Portfolio



- Ag Mortgage
 - Consumer Mortgage
 - Commercial Mortgage
- Ag Non-mortgage
 - Consumer Non-mortgage
 - Commercial Non-mortgage

Residential mortgages

A large portion of Conexus' lending portfolio is comprised of residential mortgages, which are well diversified by borrower. These loans ended 2017 at \$2.00 billion (2016 - \$1.95 billion representing 40.48% (2016 - 41.93%)) of Conexus' total loans.

Residential mortgage portfolio by amortization period

The following table presents the distribution of residential mortgages by amortization periods:

Residential mortgages portfolio by remaining amortization period		
	December 31, 2017	December 31, 2016
Amortization Period		
< 5 years	5%	5%
5- <10 years	7%	7%
10- <15 years	12%	10%
15- <20 years	15%	13%
20- <25 years	54%	52%
25- <30 years	7%	13%
> 30 years	0%	0%
Total	100%	100%

Insured and uninsured residential mortgages and home equity lines of credit (HELOC)

Conexus defines "insured" as residential mortgages that are insured individually or bulk insured through Canada Mortgage and Housing Corporation or Genworth Canada. The following table presents amounts of insured and uninsured residential mortgages and HELOC's:

Insured and uninsured residential mortgages and HELOC					
As at December 31, 2017					
(In thousands of CDN \$)	Insured		Uninsured		Total
Residential mortgages	1,132,370	54%	866,653	41%	1,999,023
HELOC	-	0%	101,090	5%	101,090
Total	1,132,370	54%	967,743	46%	2,100,113

As at December 31, 2016					
(In thousands of CDN \$)	Insured		Uninsured		Total
Residential mortgages	1,069,968	52%	882,466	43%	1,952,434
HELOC	-	0%	99,658	5%	99,658
Total	1,069,968	52%	982,124	48%	2,052,092

Loan-to-value (LTV) ratios

The following table presents the weighted average LTV ratio for total newly originated uninsured residential mortgages and HELOC's during the year:

Weighted average LTV ratio				
	December 31, 2017 - Uninsured		December 31, 2016 - Uninsured	
	Residential mortgages	HELOC	Residential mortgages	HELOC
Weighted average LTV ratio of newly originated for the year	66%	52%	67%	50%

Conexus stress tests our residential mortgage and HELOC portfolios to determine the potential impact of an economic downturn, which results in an increase in defaults and a decrease in housing prices. The stress testing uses historical delinquency information over the last 10 years. Conexus results show that in an economic downturn, which results in delinquencies well above historical levels and home prices well below historical LTV ratios, our strong capital position would be sufficient to absorb residential mortgage and HELOC losses.

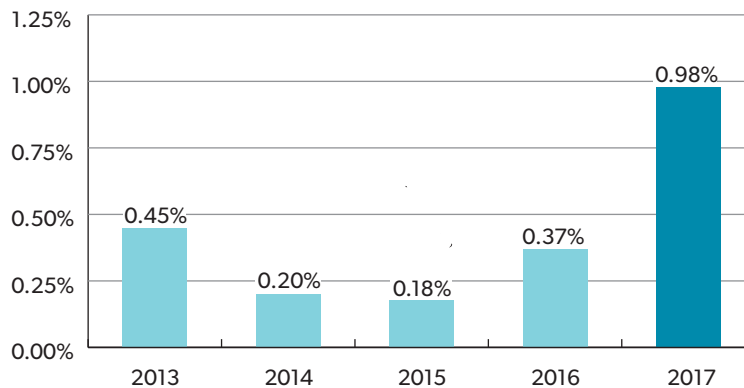
Credit Quality

In 2017 there were mixed economic results in Saskatchewan and an unemployment rate higher than recent history at 6.4%. This in general has contributed to increased delinquency, loan allowances and impairment charges for Conexus. Several larger commercial allowances and impairments in 2017 have contributed to the year-over-year increases in the credit quality measures below. Management completes detailed doubtful loan analysis (including valuation of securities) to ensure estimated impairment charges and allowances are recorded in financial results.

Past due loans and advances

Loans and advances are considered past due when a counterparty is contractually in arrears but where payment in full is expected. Delinquency greater than 90 days was 0.98% for 2017, an increase from 0.37% in 2016. Despite the year-over-year increase, delinquency levels remain well within acceptable levels

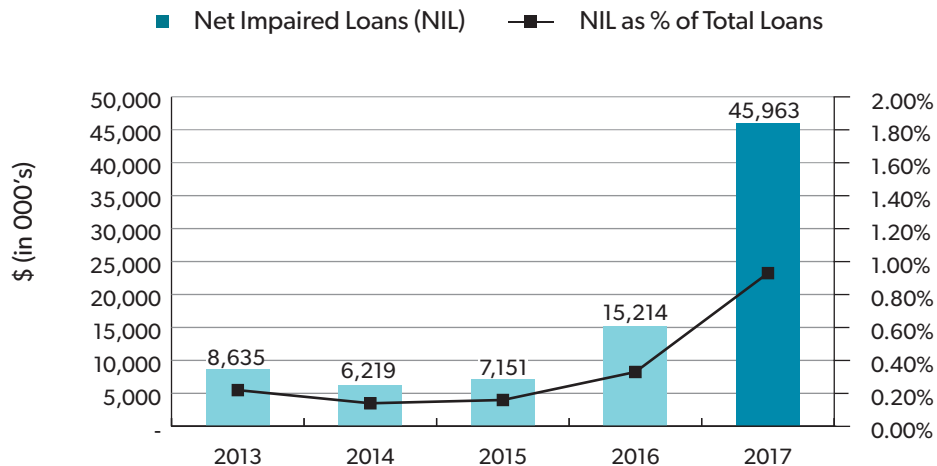
Loan Delinquency Greater Than 90 Days



Net impaired loans and advances

Net impaired loans are loans and advances considered by management to be uncollectible and are net of individual and collective loan allowances. It is the amount expected to be realized on the sale of any security on the uncollectible loans and advances. In 2017, net impaired loans and advances showed an increase from the previous year of \$30.8 million to end the year at \$46.0 million (2016 - \$15.2 million). As a percentage of total loans and advances, net impaired loans and advances increased from 0.33% in 2016 to end 2017 at 0.93%.

Net Impaired Loans



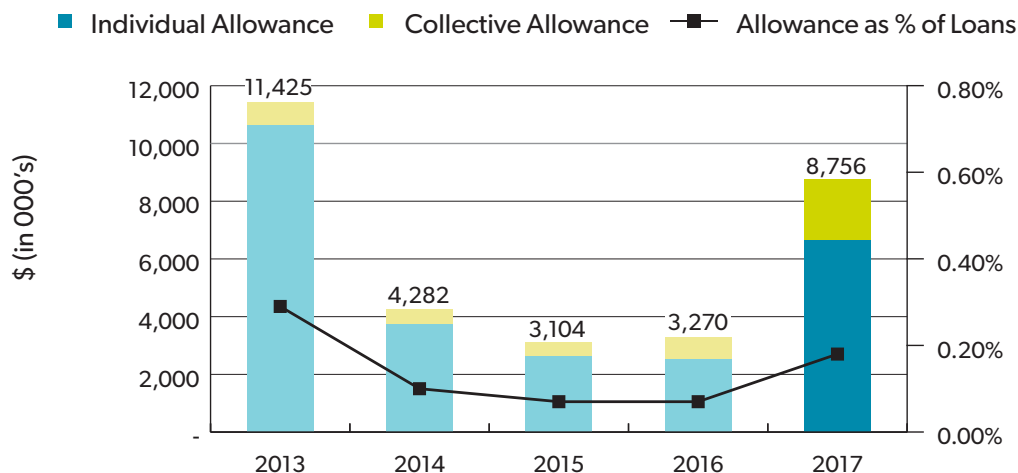
Allowance for credit losses

Conexus monitors its exposure to potential credit losses and maintains both individual and collective loan allowances accordingly.

Individual allowances are based on management's estimate of the net realizable value (NRV) of impaired loans and advances. The NRV includes any estimated future cash flows from loan payments as well as proceeds from the sale of any security. Total individual allowances increased from \$2.53 million in 2016 to \$6.63 million at the end of 2017.

Collective allowances provide for probable loan portfolio losses that have not been specifically identified as impaired. Collective allowances are assessed on six portfolio groups. Each group behaves similarly with respect to collectability, loss trigger events, and credit risk factors. These groups include: commercial mortgage and non-mortgage, consumer mortgage and non-mortgage, and agricultural mortgage and non-mortgage. The loss trigger event of delinquency greater than 90 days has increased in 2017 resulting in a total collective allowance increase from \$0.74 million in 2016 to \$2.13 million in 2017.

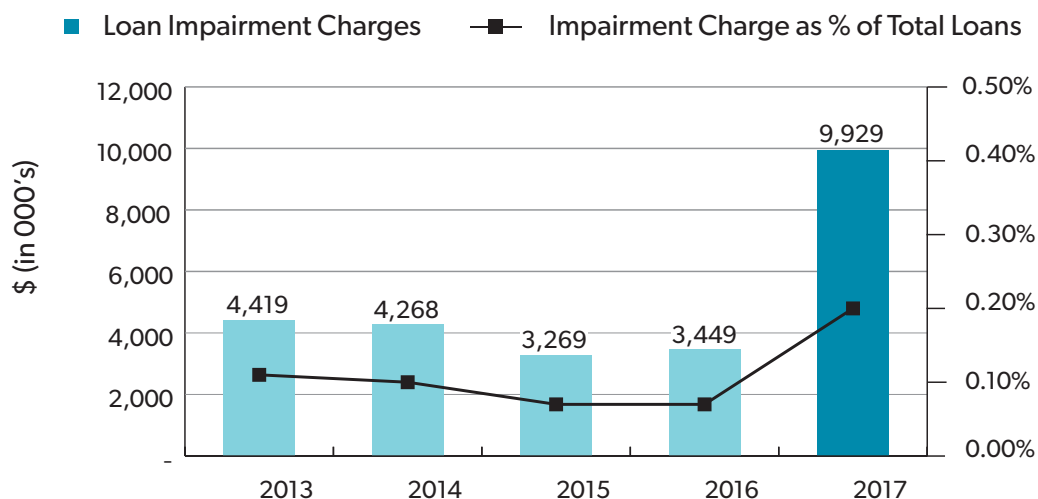
Allowance for Credit Losses



Loan impairment charges

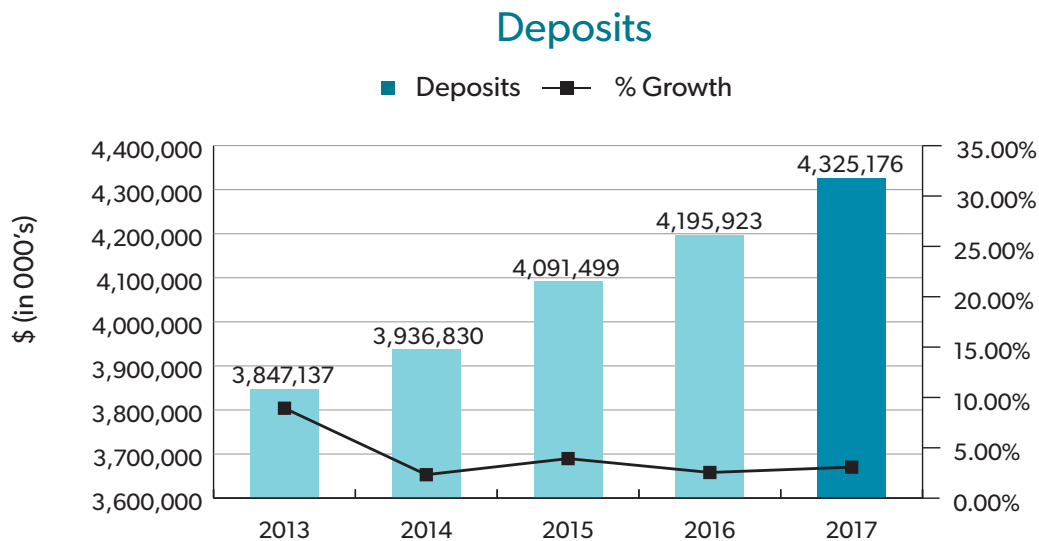
Once allowances for credit losses and write-offs have been assessed, a loan impairment charge is expensed on the Consolidated Statement of Comprehensive Income. Loan impairment charges (individual and collective) were \$9.93 million in 2017, an increase from the prior year balance of \$3.45 million. The loan impairment charges as a percentage of total loans and advances increased from the prior year to 0.20%.

Loan Impairment Charges



Deposits

Deposits ended 2017 at \$4.33 billion compared to \$4.20 billion in 2016, representing growth of 3.08%. Conexus' deposits consist of deposits from both consumer and commercial members.



Consumer deposits accounted for 61.94% of total deposits in 2017 (2016 – 62.79%), and commercial deposits accounted for 34.08% of total deposits (2016 – 33.52%). Conexus' deposits are 100 % guaranteed by the regulator of credit unions in Saskatchewan, the Credit Union Deposit Guarantee Corporation (CUDGC).

Liquidity Management

Managing liquidity is essential to maintaining the safety and soundness of the Credit Union, depositor confidence, and stability in earnings. It is Conexus' policy to ensure that sufficient liquid assets and funding capacities are available to meet commitments as they become due, even under stressed conditions. Conexus defines and manages its liquidity management framework within established corporate policies and regulatory standards.

The principles of Conexus' liquidity management framework are: maintaining a strategy and policies for managing liquidity risk; maintaining a stock of liquid assets; measuring and monitoring funding requirements; managing market access to funding sources; contingency planning; and ensuring internal controls over liquidity risk management processes.

Conexus has an established liquidity policy, along with a number of processes and practices governing the management of funding requirements. Specifically, Conexus measures and monitors its available liquidity and performs monthly stress scenario modeling to identify sources of potential liquidity strain. Conexus has built and maintains access to numerous funding sources. The organization's primary source of funds is consumer deposits in the amount of \$2.68 billion in 2017 (2016 - \$2.64 billion), which represents 61.94% of total deposits in 2017 (2016 - 62.79%). This is followed by commercial deposits that increased slightly to \$1.48 billion in 2017 (2016 - \$1.41 billion) at 34.08% (2016 – 33.52%).

In addition to core deposits, Conexus maintains external borrowing facilities from various sources. Conexus has an authorized line of credit with Credit Union Central of Saskatchewan (SaskCentral) in the amount of \$95 million in Canadian funds, as well as authorized lines of credit with Concentra Financial Services Association (Concentra) in the amount of \$7 million in U.S. funds and \$50 million in Canadian funds. Conexus also has a credit agreement with Caisse Centrale Desjardins, with a maximum available credit limit of \$100 million. SaskCentral is a wholesale financial services co-operative that provides trade association and liquidity management services to its member owners – the Saskatchewan credit unions. Concentra is owned by SaskCentral, other provincial centrals, and credit union partners; it provides wholesale banking services and consulting support to Canadian credit unions.

The next source of liquidity for Conexus is the securitization of assets for the purpose of generating funds on the capital markets. Conexus' securitization activities include participation in the Canada Mortgage Bond (CMB) program, the sale of mortgage-backed securities (MBS), and a revolving dealer finance loan pool. Loans and advances are also syndicated with numerous credit unions for liquidity and diversification purposes thereby achieving off-balance sheet treatment as all credit risk is assumed by the purchaser. In 2017, Conexus securitized an additional \$228.94 million in loans and advances (2016 - \$120.04 million) and syndicated an additional \$110.08 million in loans and advances (2016 - \$56.09 million) as part of its ongoing funding strategies.

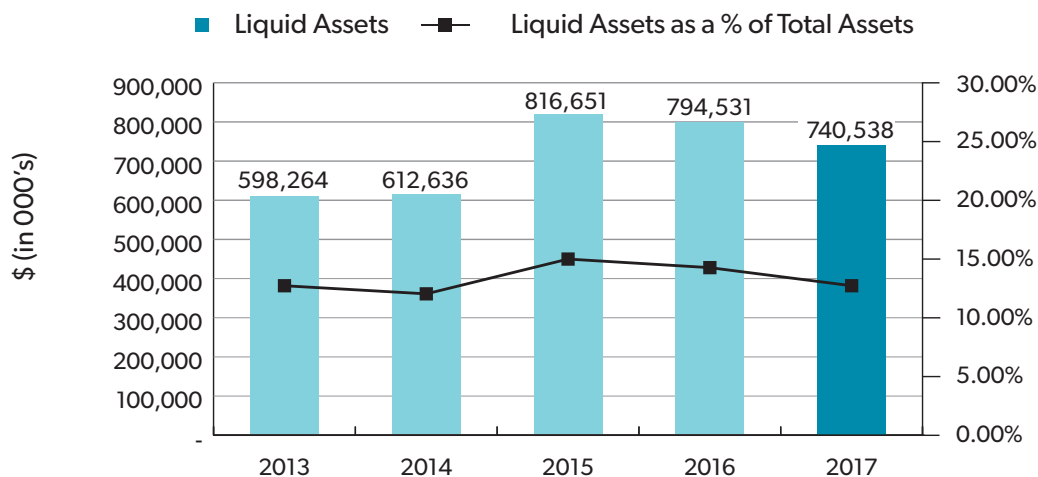
Liquid assets

Conexus also maintains a cushion of high-quality liquid assets that it can draw upon to meet unforeseen funding requirements.

Liquid assets include cash and cash equivalents, marketable investment securities, liquid investment securities held with Concentra, and statutory liquidity investment securities at SaskCentral. The value of liquid assets decreased from \$794.53 million (14.27% of assets) in 2016 to \$740.54 million (12.73% of assets) as of December 31, 2017.

Saskatchewan credit unions are required by the provincial regulator, CUDGC, to maintain 10% of their liabilities on deposit with SaskCentral, manager of the Provincial Liquidity Program. Throughout 2017, Conexus held the required amount of investment securities with SaskCentral for the purpose of maintaining its obligation to the Provincial Liquidity Program. In addition to the statutory liquidity investment securities on deposit with SaskCentral, Conexus maintains a high-quality, liquid pool of investment securities to satisfy payment obligations and protect against unforeseen liquidity events. The majority of Conexus' marketable investment securities are held in provincial government and Canadian (Schedule 1) Chartered Banks.

Liquid Assets



Operating liquidity

Conexus' liquidity is measured by the operating liquidity ratio and the liquidity coverage ratio.

The operating liquidity ratio is calculated as available liquidity and cash inflows divided by cash outflows. Available liquidity is defined as investment securities which are immediately available as cash, investment securities marketable in an active secondary market, redeemable investment securities held with Concentra, and committed credit facilities. In 2016, the ratio was 278%, and in 2017 it was 202%, well above management's internal target of 150%.

The liquidity coverage ratio (LCR) is a ratio that measures the amount of high quality liquid assets (HQLA) in relation to net cash flows (obligations) over a 30 calendar day liquidity stress scenario. The ratio is calculated as HQLA divided by obligations. The ratio came into effect as a liquidity adequacy requirement of 80% or higher from CUDGC on January 1, 2017, increasing to 90% in January 2018 and 100% in January 2019. The LCR measure ended 2017 at 115% and above the regulatory minimum.

Capital Management

Total capital as a percentage of risk-weighted assets is one of our primary measures of financial strength. Conexus' capital management framework is designed to balance the desire to optimize capital productivity and ensure sufficiency of capital given risks. This appropriate balance can be referred to as capital adequacy. Accordingly, capital policies are designed to ensure that Conexus: meets its regulatory capital requirements; meets its internal assessment of required capital; and builds long-term membership value. Conexus retains a portion of its annual earnings in order to meet these capital objectives.

CUDGC prescribes capital adequacy measures and minimum capital requirements. The capital adequacy rules issued by CUDGC are based on the Basel III capital standards framework established by the Bank for International Settlements and adopted by financial institutions around the globe, including Canadian banks. Conexus monitors changes in regulatory standards and guidelines and adjusts its capital plan and targets accordingly.

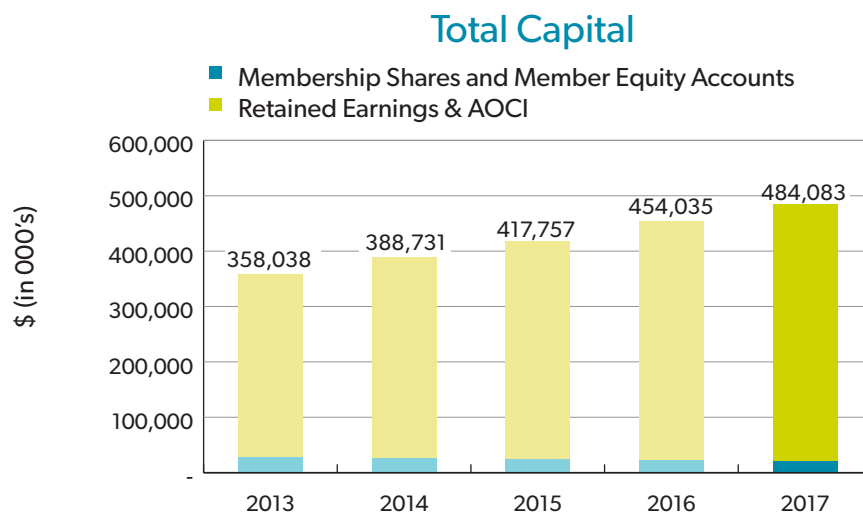
CUDGC currently prescribes four standardized tests to assess the capital adequacy of credit unions: risk-weighted capital ratio (total eligible capital to risk-weighted assets); common equity tier 1 capital to risk-weighted assets; total tier 1 capital to risk-weighted assets; and a minimum leverage ratio (eligible capital to total leveraged assets). The risk-weighted capital ratio is calculated as total eligible capital divided by risk-weighted assets. Regulatory standards require credit unions to maintain a minimum risk-weighted capital ratio of 10.5%, a minimum common equity tier 1 capital to risk-weighted assets of 7.0%, total tier 1 capital to risk-weighted assets of 8.5%, and a minimum leverage ratio of 5.0%.

CUDGC also prescribes an internal capital adequacy assessment process (ICAAP). ICAAP is an integrated process that evaluates capital adequacy, and is used to establish capital targets that take into consideration the strategic direction (business plan) and risk appetite of the credit union. ICAAP seeks to identify the material risks requiring capital and quantify the amount of capital that should be held in relation to those risks. Enterprise-wide stress testing and scenario analysis are also used to assess the impact of various stress conditions on Conexus' risk profile and capital requirements.

Achieving minimum regulatory capital levels are of paramount importance to Conexus. Minimum board-level standards are set well in excess of regulatory minimums. Board policy requires the credit union to maintain a minimum risk-weighted capital ratio of 11.5%, a minimum common equity tier 1 capital to risk-weighted assets of 8.0%, minimum total tier 1 equity to risk-weighted assets of 9.5%, and a minimum leverage ratio of 5.75%. This standard-setting is the first line of defense to ensure capital levels exceed regulatory minimums even in times of significant loss or unplanned growth. In addition to board-level minimums for capital adequacy, internal capital targets are set and reviewed annually through the Credit Union's ICAAP. ICAAP targets and the underlying risk assessment process is approved annually by the Risk Committee of the Board. Conexus manages capital to these operating objectives. Balance sheet operating strategies are designed to ensure these capital levels are achieved in addition to other strategies, such as growth and profitability targets.

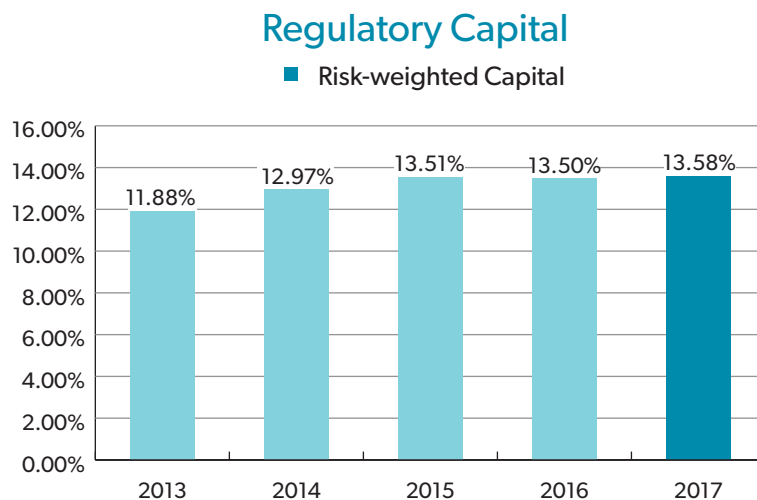
Capital planning is integrated with Conexus' business planning. Conexus' capital plan must demonstrate its ability to meet both board-level capital standards and those established through ICAAP. A capital plan is prepared annually and approved by the Audit and Conduct Review Committee.

Conexus experienced capital growth in 2017, adding to its sound financial position. In 2017, the total capital of Conexus increased by \$30.04 million, from \$454.04 million in 2016 to \$484.08 million. Total capital of Conexus consists of: amounts held in membership shares and member equity accounts (\$20.74 million in 2017); accumulated other comprehensive income (AOCI) ((\$1.91 million) in 2017); and retained earnings (\$465.25 million in 2017). The following chart illustrates the capital composition of Conexus, showing that retained earnings remain the key sources of capital for Conexus.



Regulatory capital

For the year ending 2017, Conexus' total capital as a percentage of risk-weighted assets was 13.58% (2016 – 13.50%). Common equity tier 1 capital to risk-weighted assets was 12.94% (2016 – 12.80%), and the leverage ratio was 8.02% (2016 – 7.79%), all well above the minimum regulatory standards, policy requirements, and those established through the ICAAP.



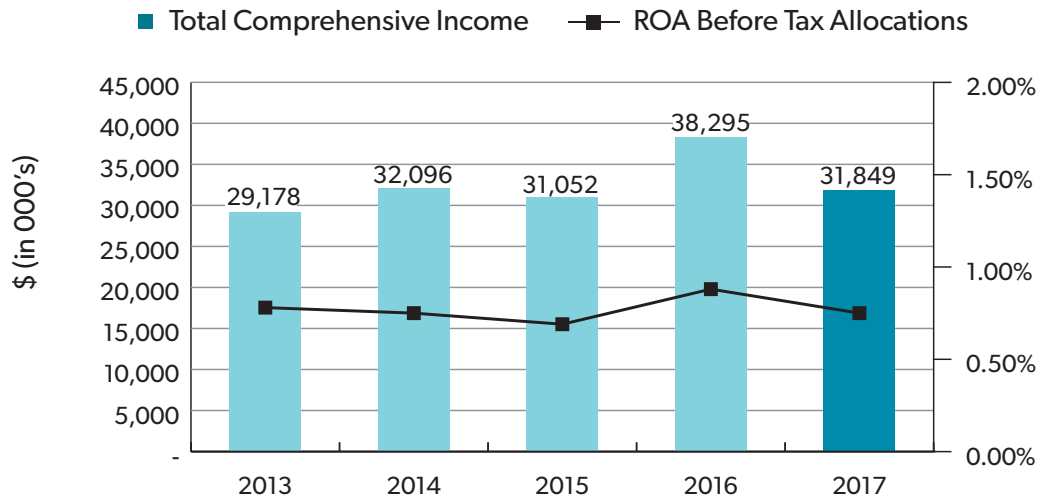
Financial Performance Review

The financial performance review provides an analysis of our consolidated financial performance and member return. The results below are drawn from continuing operations unless otherwise specified.

Profitability

Total comprehensive income for the year was \$31.85 million, a decrease from \$38.30 million in the previous year. For 2017, total annualized return on assets (ROA) before income tax allocations was 0.75%, compared to 0.88% in 2016. In 2016, Conexus sold a subsidiary - Conexus Insurance Ltd., resulting in a non-operating one-time gain on sale. Excluding this one-time gain, ROA in 2016 was 0.68%.

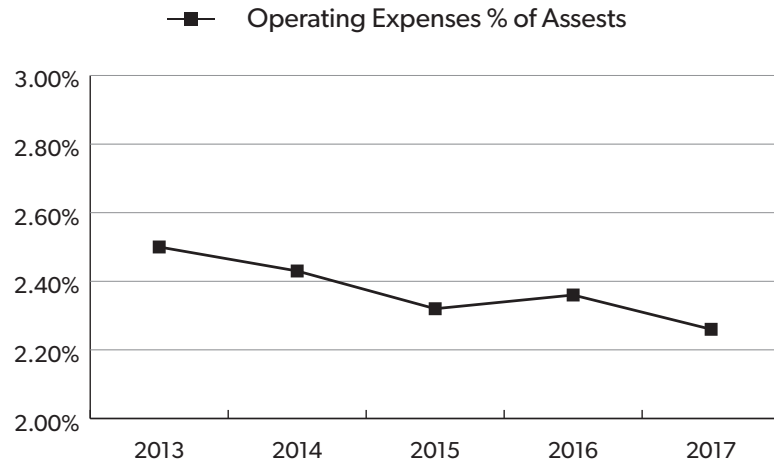
Total Comprehensive Income and ROA



Total comprehensive income is comprised of the following items:

- **Net interest income after impairment charges:** consists of total interest income less total interest expenses while factoring in any loans and advances, and investment security impairment charges. Net interest income after impairment charges increased \$2.79 million between December 31, 2017 and 2016. Expressed as a percentage of total assets, net interest income decreased slightly to 2.23% for 2017 compared to 2.28% in 2016.
- **Other income:** includes account service fees, loan fees, loan insurance fees, ABM fees, dividend income, and wealth management income. Consolidated other income decreased to \$45.3 million in 2017 from \$53.7 million in 2016. Removing the one-time gain on sale of Conexus Insurance in 2016 would result in other income increasing from \$42.0 million in 2016 to the \$45.3 million in 2017 – an increase of \$3.3 million or 7.86%.
- **Operating expenses:** includes various operating costs such as general business, occupancy, organizational, personnel, and member security. Consolidated operating expense from continuing operations increased marginally in dollar value but decreased as a percentage of assets, from 2.36% of assets or \$131.19 million in 2016 to 2.26% of assets or \$131.21 million in 2017. This ratio has been declining since 2013 which demonstrates management's focus and success of managing operating costs in a time of declining margins from loan and deposit activity and a need to make strategic investments for the ongoing competitiveness of the credit union. This ratio of operating expenses divided by total assets is called the operating expense ratio and is included as a measure of efficiency in Conexus' key performance indicators report to ensure all staff and management focus on operating cost management.

Operating Expenses

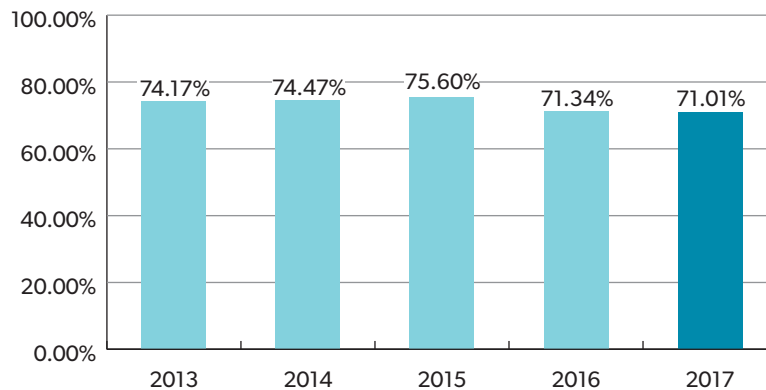


Efficiency

The efficiency ratio measures the percentage of income from operations earned that is spent on the operation of the business. A low-efficiency ratio indicates efficient use of resources. The ratio is calculated as operating expenses from operations divided by the sum of the following: net interest income plus other income from operations and loan impairment charges.

The efficiency ratio was 71.01% in 2017 compared to 71.34% in 2016, a favourable decrease of 0.33%. The one-time gain on the sale of Conexus Insurance Ltd. is included in other income in 2016, adding to the year over year favourable movement in the efficiency ratio. Excluding this gain, the efficiency ratio was 76.17% in 2016; resulting in an even more favourable decline of 5.16% in the efficiency ratio.

Efficiency Ratio



Enterprise Risk Management

Overview

As a financial institution, Conexus is exposed to a variety of risks. To actively manage these risks, Conexus has implemented an enterprise-wide risk management (ERM) approach, which identifies, measures, and monitors risks.

Risk Governance

Risk governance includes setting the risk appetite and policy, determining an appropriate organizational structure, and clearly defining authority and responsibility for risk decisions. The following groups and committees have the authority and responsibility to make risk decisions within Conexus.

Board of Directors

- Set strategy and high-level objectives
- Approve risk policies and set risk appetite
- Know the extent to which effective ERM has been established within the organization
- Be aware of significant risks and whether management has appropriately responded
- Review and assess the impact of business strategies, opportunities, and initiatives on overall risk position

Risk Committee

- Monitor major risks and recommend acceptable risk levels to the board
- Review the appropriateness and effectiveness of risk management and compliance practices

Executive Management

- Ensure, through the chief executive officer, that all ERM components are in place
- Set objectives, establish organizational structure, and develop the risk culture
- Ensure that a supportive learning environment exists

Management Risk Committee

- Oversee the ERM function
- Ensure compliance with the risk appetite
- Review status of significant risk areas and key risks
- Review and recommend changes to board policy
- Review operating policy changes
- Review and recommend risk appetite statement to the board

Chief Risk and Compliance Officer

- Lead the ERM function
- Ensure risk is considered in strategic direction-setting
- Support and demonstrate the importance of ERM
- Maintain and develop the risk governance framework

ERM Department

- Act as a centralized co-ordinator to facilitate ERM
- Establish ERM policies, define roles and responsibilities, and set goals for implementation
- Promote ERM competence
- Examine and evaluate the effectiveness of the ERM framework, tracking progress and reporting on best practices
- Oversee the insurance risk management program
- Oversee the business continuity management program

Senior Management

- Manage risk related to unit objectives
- Assume responsibility and accountability
- Integrate risk management into department strategy and management practices
- Identify events, assess risks, and respond accordingly

Internal Audit, Compliance and ERM Departments

- Oversee enterprise-wide management of compliance throughout the organization
- Provide independent and objective assurance of control and soundness of operations to management, Audit Committee and Risk Committee of the board
- Monitor compliance with policy and procedure, and the adequacy of controls

Credit Management Department

- Establish credit policies and oversee credit risk management
- Monitor credit risk profile and risk exposures
- Monitor compliance with credit risk policies
- Approve high-risk individual credit applications

Asset Liability Committee

- Establish market and liquidity risk policies and oversee related programs and practices
- Monitor overall market and liquidity risk profile, key and emerging risk exposures, and risk management activities
- Monitor compliance with market and liquidity risk policies
- Establish balance sheet operational strategies with a focus on achieving financial targets, managing market and liquidity risk, and optimizing the use of capital

Pricing Committee

- Establish pricing policies and tools
- Ensure that policies facilitate appropriate return given the level of risk in individual accounts
- Monitor pricing decisions to ensure compliance to policy

Functional Advisors/Supervisors

- Provide support in shaping effective ERM components
- Ensure policy-related advice and guidance is in line with corporate ERM and strategic objectives
- Identify and assess risk and the effectiveness of existing risk management practices
- Help design and implement tools for more effective risk management

All Employees

- Be aware of risk management issues
- Practice risk aware behaviour
- Consider limitations and understand the risks they can and cannot take
- Execute day-to-day activities in accordance with established directives and protocols

Risk Identification, Measurement and Assessment

The ERM framework sets out how risk management is designed and will function at Conexus. Risks will be identified and assessed, and mitigation plans will be documented, through the use of a risk register. Risks are evaluated and prioritized on the potential impact that they could have and the likelihood that they might occur.

Risks considered to be at a tolerable risk level are managed through normal operating policy and procedures. Risks carrying a slightly higher risk level receive ongoing monitoring. Risks carrying high risk levels are escalated to the management risk committee for monitoring, and they are reported to the board. If any risk is assessed as intolerable, a timely and appropriate response is required.

Risk Monitoring and Reporting

ERM reporting requirements are specified in board policy. Reports are submitted quarterly to the Risk Committee, providing updates on significant risk categories and key business risks. The full board of directors is provided access to all reports that are submitted to the Risk Committee. Reporting through the course of the year includes risk details such as a listing of key risks, a risk map, insurance program review, and an evaluation of the ERM and business continuity management program implementation. Internal audit, and occasionally the Credit Union Deposit Guarantee Corporation, also completes an independent evaluation.

A dedicated executive-level risk committee, the Management Risk Committee, meets at least quarterly to review significant risk categories, and to discuss changes to the risk environment, risk impacts on strategic objectives, and emerging risks.

Risk Control and Mitigation

Management implements policies and procedures to carry out risk mitigation and treatment actions. The Conexus ERM framework establishes that risk owners are generally responsible for controls. The ERM department reports on the adequacy of controls, and the internal audit department tests controls and reports on whether they are functioning as intended.

The executive team takes risks into consideration when creating the corporate plan and balanced scorecard. Key initiatives have been put in place to manage risk priorities.

Significant Risk Areas

In addition to tracking individual key risks, analysis is done on the following six categories of risk that are significant to Conexus: strategic, market, liquidity, credit, legal and regulatory, and operational. Within each of these categories are various individual risks, and Conexus recognizes that any combination of the above-noted risks can affect the organization's reputational risk.

For each risk area, Conexus conducts an assessment to measure the inherent risks in that area, the effectiveness of risk management controls, and the residual risk. Inherent risk is the "raw" risk of the category if controls were not in place. It can be rated as low, minor, moderate, or high. The effectiveness of risk management controls can be rated as satisfactory, needs improvement, or inadequate. Residual risk is the remaining inherent risk which has not been mitigated by risk management controls. It can be rated as low, minor, moderate, or high.

A. Strategic Risk

Strategic risk encompasses the possibility that business decisions or plans could be flawed, and thus impact our ability to meet objectives. This risk can take the form of adverse business decisions, or ineffective or inappropriate business plans. It could also be a failure to respond to changes in the competitive environment, member preferences, or product obsolescence. Products and services must be competitive and profitable, and resources must be used appropriately in order for Conexus to be successful.

Key strategic risks

The following are key strategic risks that have been identified at Conexus:

- Competition - Increased pressures from existing and non-traditional financial service providers (Fintech, Big Tech, and new entrants) are influencing consumers' expectations of services thereby challenging member loyalty. Financial technology and other disintermediation activities are entering the market and are leading to new and efficient delivery channels and an uncoupling of financial products and services, making it increasingly difficult to offer a seamless relationship based program to achieve growth organically.
- Strategic Focus - There is a risk that Conexus may lose focus on the top priorities needed to digitally and operationally transform the delivery of the Conexus strategic differentiator, Member Financial Well-being, and the evolution toward operational excellence. If Conexus cannot maintain an enterprise wide focus on priorities, there is risk that objectives will not be met.
- Consumer Uptake of Strategic Differentiator - Conexus is dedicated to achieving the strategic differentiator of delivering a compelling member focused financial wellness offering. "Financial Well-being" is becoming a buzz word for many financial service providers, therefore the meaning of financial well-being is being defined by others and at risk of being viewed as a commodity by consumers. To succeed, Conexus must convince consumers of our difference and demonstrate the value.
- Data as an Asset - Data is a core asset which must be managed in order to successfully deliver on Conexus' vision of Member Financial Well-being and other corporate objectives. Competitors and Fintechs are perceived to be sophisticated data users with the ability to leverage data to create a business competitive advantage which Conexus must be able to compete against. In order for data to be an asset, it must be of high quality, accessible, timely, adaptable, reliable and usable. These characteristics create and preserve value through analytical approaches to member insight, increased efficiency and innovative approaches.

Strategic Risk Management

Conexus has an ongoing strategic planning cycle, which includes planning sessions for the board and executive management. Strategic and operational planning is organized and led by the governance and strategy department. Strategic objectives, performance measures, and key initiatives are identified and form part of the balanced scorecard, which is communicated to all staff and used to measure organizational performance. Risk identification is part of Conexus' operational planning process, ensuring that strategic risk identification is incorporated at all levels within the organization.

The inherent risk level of strategic risk is rated as high, Risk management practices are rated as needs improvement and residual risk levels is rated as high.

B. Market Risk

Market risk is the exposure to potential loss from changes in market prices or rates. Losses can occur when values of assets and liabilities, or changes in revenues or expenses, are adversely affected by changes in market conditions, such as interest rate or foreign exchange movements. At Conexus, market risk primarily arises from movements in interest rates and is caused specifically from timing differences in the re-pricing of assets and liabilities, both on and off the balance sheet.

Key market risk

The following key risks have been identified in this category:

- **Capital Growth** - To maintain strength and stability, Conexus is required to grow or access capital to achieve capital adequacy targets in an environment of increased balance sheet growth, innovation investment, economic uncertainty and regulatory expectations. The primary means of growing capital is through retention of earnings (profitability). There is a risk that Conexus' cost structure and margin is unable to adequately sustain planned balance sheet growth and risk levels.

Market Risk Management

Effective management of market risk includes documented board and operating policies which address roles and responsibilities, delegation of authority and limits, risk measurement and reporting, valuation and back testing, hedging policies, and exception management. Some elements of market risk management have been discussed in other parts of this report. Market risk exposure limits have been set in Conexus policy, and methods of scenario and stress testing are carried out to determine if the limits are exceeded. The corporate finance department is responsible for reporting on and monitoring market risk, with oversight by the Asset Liability Committee and reporting provided quarterly to the board of directors. Interest rate risk management includes the use of derivatives to exchange floating rate and fixed rate cash flows.

The inherent risk level of market risk at Conexus is moderate, the same as it was in 2016. Risk management practices are rated as satisfactory. The residual risk level of market risk is rated as moderate.

C. Liquidity Risk

Liquidity risk is the potential inability to meet obligations, such as liability maturities, deposit withdrawals, or funding loans, without incurring unacceptable losses. Liquidity risk includes the inability to manage unplanned decreases or changes in funding sources.

Key liquidity risk

The following key risks have been identified in this category:

- **Liquidity Risk** – Low interest rates, diversification of deposits, competition for core deposits, increase in non-deposit investments and a declining preference for saving by a growing segment of the population has decreased deposit growth rates. This has created an increased reliance on alternate funding instruments, which creates exposure to capital markets, in order to fund loan demand. Saskatchewan credit unions do not have explicit provincial government liquidity backstop support.

Liquidity risk management

Liquidity risk management includes board and operating policies which address roles and responsibilities, delegation of authority and limits, risk measurements, stress testing, and reporting. Operational management of liquidity risk includes daily, monthly, and annual liquidity management processes and planning. Liquidity planning takes into account the Conexus strategic plan, diversity of on and off-balance sheet funding sources, and diversity and liquidity of assets. Some elements of liquidity risk management have been discussed in other parts of this report. The corporate finance department is responsible for reporting on and monitoring liquidity risk, with oversight by the Asset Liability Committee and reporting provided quarterly to the board of directors.

The inherent risk level of liquidity risk is high, the same as it was in 2016. Risk management practices are rated as needs improvement. The residual risk level of liquidity risk is rated as moderate.

D. Credit Risk

Credit risk is the loss of principal resulting from a borrower's failure to repay a contractual credit obligation. Credit losses occur when the borrower fails to make contractual payments and the realizable value of security is less than the outstanding principal of the credit.

At Conexus, credit risk comes primarily from our direct lending activities and, to a lesser extent, our holdings of investment securities.

Key credit risk

The following key risk has been identified in this category:

- **Credit Risk** – The geographic limitations within which Conexus operates creates a credit portfolio with increased geographic and industry concentrations resulting in higher levels of exposure to localized economic and natural events. The recent economic challenges within Saskatchewan, coupled with an extended period of low interest rates, has created an environment where an increase in interest rates would materially impact member debt service ratios.

Credit risk management

Credit granting is controlled by board-approved policies and detailed loan policy manuals. Credit approvals require escalation based on operational lending policy, which is reviewed on a scheduled basis. Quarterly credit management reports provide loan portfolio details on loans by industry type, internal risk weighting where available, and property type for mortgages. Credit portfolio management entails using a variety of strategies to achieve a target loan portfolio. The credit management centre is responsible for the creation of appropriate operating policy and the overall management of credit risk. The Asset Liability Committee sets operating targets for loan growth and portfolio mix, and recommends strategies to achieve those targets. A variety of appropriate strategies, ranging from special pricing on specific loans to syndication or securitization, are used.

The inherent risk level of credit risk is moderate, the same as it was in 2016. Risk management practices are rated as needs improvement. The residual risk level of credit risk is rated as moderate.

E. Legal and Regulatory Risk

Legal and regulatory risk is the risk arising from potential violations of, or non-conformance with laws, rules, regulations, prescribed practices, or ethical standards.

Key legal and regulatory risks

There are no key risks identified in this category.

Legal and regulatory risk management

As a financial institution, Conexus operates in a heavily regulated environment. As a business operating within Saskatchewan, we are also subject to all provincial and federal legislation applicable to our operations, such as labour and anti-money-laundering laws. Board policy, operating policy, operating procedure, and a corporate code of conduct raise awareness and accountability in complying with laws and regulations.

A corporate compliance department that maintains risk oversight and co-ordinates quarterly reporting to the board is in place at Conexus. Operational compliance employees ensure compliance in key regulatory areas. All specialized departments (wealth management, credit, finance, and retail) are knowledgeable in the specific regulations applicable to their areas, and where required, third-party expertise is consulted to ensure sound decision-making. Employees are responsible for compliance within their scope of responsibilities. Mandatory annual training and reviews are required for specific regulatory requirements and key human resource operating policies and guidelines.

The inherent risk level of legal and regulatory risk is moderate, the same as it was in 2016. Risk management practices are considered satisfactory. The residual risk level of legal and regulatory risk is rated as moderate, an increase from minor in 2016.

F. Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people, and systems, or external events. Exposures to this risk arise from deficiencies in internal controls, technology failures, human error, employee integrity, or natural disasters.

Key operational risks

The key risks identified in this category are:

- **Human Resource Risk** - Conexus is progressing through transformational change which requires specifically skilled change leaders and proficient self-management by all employees. Failing to accept change will delay process improvement benefits and places Conexus at a competitive disadvantage. The pace and management of changes associated with the initiation of new programs, systems and processes creates employee capacity and retention concerns and increased employee stress levels. Increased employee turnover, associated with an aging workforce, creates the risk of losing operational knowledge and results in significant knowledge transfer efforts. Saskatchewan's low unemployment rate has created skilled labour shortages in certain professional areas.
- **Technology (Cyber) Security** – Conexus' use of electronic member service delivery channels, including online and mobile technology, combined with increasing incidents of privacy and technology breaches across the corporate environment, creates a vulnerability to financial loss and reputation risk. Technological infrastructure security requires a more robust approach.
- **Operational Process Risk** – There are numerous operating processes which are not automated, nor do they empower employees to provide quality service to members. Delaying the creation and acceptance of process change initiatives will result in the failure to achieve efficiency goals, long-term financial sustainability, as well as lead to inconsistent member delivery compared to brand promise and the goals of the sales and service strategy. There is potential risk that processes do not provide the optimum risk treatment for the amount of business risk, which could lead to either financial loss or inefficiencies in service delivery.

Operational risk management

At Conexus, operational risk exists in all products and services, as well as in the way we deliver them, such as how we support back office processes and systems. We categorize our operating risk into three main areas: people, systems, and processes. The people category includes our human resources and covers risks such as our ability to attract and retain appropriate talent. The systems category addresses technology and our reliance on it, encompassing such risks as a security breach or failure of a critical system for an extended period. The processes category includes the way we do things and risks such as inaccurate policies or procedures.

Operational risk is managed through the use of preventative measures including policies and procedures, controls, and monitoring. Control and monitoring involves segregation of duties, employee training, performance management, and a structured internal audit program. Other mitigation includes business continuity planning, appropriate insurance coverage, and secure technology solutions.

Conexus' people risk is controlled through board and operating policy, and it is specifically managed by the Conexus human resources department. Individual departments and managers are accountable to ensure appropriate hiring, training, and development of staff, as well as ongoing employee engagement and retention with the assistance of the human resource department.

System risk management is jointly controlled through dedicated information technology departments, which are responsible for ongoing system security and functionality, and individual departments, which are responsible to ensure the appropriateness of systems and data used at Conexus.

Process risk is managed through multiple channels. Board policy is reviewed and recommended by an executive-level committee for board approval. Operating policy and procedure, which is centrally available to all staff, is controlled through key departments with the required subject matter expertise, and it is also reviewed by an executive-level committee. The internal audit department conducts ongoing assessments of process compliance and reports the findings directly to the Audit and Risk Committee of the board.

The inherent risk for operational risk is assessed according to the three main operational risk categories. The inherent risk level for people risk is assessed as moderate, the same as it was in 2016, the inherent risk level for systems risk and processes risk is assessed as high, the same as it was in 2016. Risk management practices are rated as needs improvement for all categories. Residual risk for both people and systems risk is rated as moderate, the same as it was in 2016. Operational process residual risk has increased from moderate in 2016 to high in 2017.



Branch Locations

CU Conexus Credit Union

