

Management Discussion and Analysis



2019
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, 2019 compared with the prior year and plans. This MD&A is prepared in conjunction with the Consolidated Financial Statements and related Notes for the year ending December 31, 2019 and should be read together with those documents. The MD&A includes information up to February 14, 2020. Unless otherwise indicated, all amounts are expressed in Canadian dollars. Amounts for 2015, 2016, 2017, 2018 and 2019 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

- 2019 economic and financial services conditions
- Economic and financial outlook for 2020

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 of significant risks

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 effect 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

2019 Economic and Financial Services Conditions

The global economy annual real GDP growth was 3.00% in 2019 down from 3.60% in 2018. The global economy saw a large slowdown due to the trade tensions that took place between the United States and China as well as unstable economic results from developed nations around the world including the US, Germany, China and Japan.

In the United States, the real annual GDP growth rate finished the year at 2.30% down from 2.50% in the year prior. This weakness in the economy was noticed by the Federal Reserve as they cut the Federal funds rate by 25bps on three separate occasions through 2019 in hopes to slow contraction and stimulate the economy. Non-farm payroll in the United States, which represents new jobs added to the economy, averaged 158,000 per month through 2019, which dropped from 223,000 in 2018. Unemployment went in the other direction as it improved throughout 2019, decreasing from 4.00% to 3.50% by the end of 2019.

In Canada, the economy was stable across most economic indicators until the latter part of the year where signs of weakness began to emerge. Real annual GDP growth slowed from 1.90% in 2018 to 1.50% in 2019. The Bank of Canada overnight target rate remained flat at 1.75% throughout 2019 due to inconsistent economic results during the year. Canadian housing prices jumped 9.60% from December 2018 to December 2019, mainly driven by Ontario and Quebec. The prairie provinces all saw prices increase less than 1.00% year over year.

Saskatchewan's growth ended the year at 1.60%, which was the lowest of all of the Canadian provinces. Production challenges in potash and uranium, as well as market access in the oil and gas sector were significant factors, along with an exceptionally challenging year in agriculture. The average unemployment rate fell from 6.10% to 5.40% year over year. This was fueled by the number of people employed, as that number grew by 1.20% when comparing December 2019 to the previous year. Due to oversupply and a weaker economy, Saskatchewan's housing starts fell 31.10% in 2019 compared to 2018. This year saw the lowest housing starts in the province since 2009.

Economic and Financial Outlook for 2020

The global outlook is beginning to recover as a phase one trade deal has been signed between China and the United States, putting a pause to the ongoing trade tensions. Also, some of the largest economies are bouncing back from a weak 2019 as global annual GDP growth is forecast to be 3.40% for 2020, representing a 40bp increase from 2019. Global stock markets have recently taken a hit as consumers move to safety in the bond markets to start the year due to the spread of the coronavirus. If this is not dealt with quickly, this could have a lasting impact on the global economy for 2020. Uncertainty surrounding the implications of Brexit could also play into global stability.

Driven by manufacturing Purchasing Managers' Index (PMI) falling year over year, struggling commodities and fewer exports throughout the year, the Bank of Canada has begun signaling towards cutting its target overnight rate in mid-late 2020. That being said, the Bank is not rushing to cut rates as some of the fundamental economic indicators still signal signs of strength for the Canadian economy. Mediocre growth of 1.30-1.80% is forecasted for Canada in 2020 as a healthy labour market and development in the housing sector will assist growth over the next 12 months.

The outlook for Saskatchewan is not as bright as the rest of the country as the lower commodity prices, the impacts from the trade war and the oversupply of housing take their toll on growth within the province. Growth is expected to fall from 1.60% to 1.30% in 2020. The production of commodities will have a lasting impact on the economic growth for the province this year as oil, uranium and potash have a significant influence on the economy. Population growth has been mainly attributed to international immigration and this is forecasted to continue through 2020 as negative interprovincial migration has continued to weigh on the province's demographic prospects.

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 2019 plan. Actual results for 2019, 2018, 2017, 2016 and 2015 have also been included for comparison.

Financial Management

<i>(In thousands of CDN \$)</i>	2019 Actual	2019 Plan	2018 Actual	2017 Actual	2016 Actual	2015 Actual
Growth						
Assets	6,554,441	6,659,165	6,260,155	5,818,734	5,568,186	5,442,574
Asset growth	4.70%	6.37%	7.59%	4.50%	2.31%	6.96%
Deposits	4,902,020	4,975,177	4,765,586	4,325,176	4,195,923	4,091,499
Deposit growth	2.86%	4.40%	10.18%	3.08%	2.55%	3.93%
Loans and advances	5,445,962	5,599,931	5,276,887	4,948,361	4,668,855	4,488,575
Loans and advances growth	3.20%	6.12%	6.64%	5.99%	4.02%	3.56%
Credit quality						
Delinquency greater than 90 days	1.82%	2.74%	1.33%	0.98%	0.37%	0.18%
Net impaired loans and advances	98,109	39,437	77,548	45,963	15,214	7,151
Allowance for credit losses	21,850	14,887	16,259	8,756	3,270	3,104
Impairment charges	14,514	9,821	16,100	9,929	3,449	3,269
Liquidity management						
Liquid assets *	871,380	851,268	827,161	740,538	794,531	816,651
Investment securities and interest bearing deposits	934,162	862,328	737,780	650,669	679,229	687,505
Liquidity coverage ratio (LCR) **	295.80%	170%	242.91%	112.12%	n/a	n/a
Liquid assets as a % of total assets	13.29%	12.78%	13.21%	12.73%	14.27%	15.00%
Capital management						
Risk-weighted capital	13.40%	13.20%	13.06%	13.58%	13.50%	13.51%
Common equity tier 1 capital to risk-weighted assets	12.79%	12.64%	12.42%	12.94%	12.80%	12.11%
Leverage ratio	8.19%	8.11%	8.05%	8.02%	7.79%	7.68%
Total capital ***	551,225	561,348	522,726	484,083	454,035	417,757
Profitability and member return						
Total comprehensive income for the year	30,346	39,305	41,954	31,849	38,295	31,052
Return on assets (ROA) before tax allocations	0.55%	0.78%	0.87%	0.75%	0.88%	0.69%
Efficiency ratio	74.87%	70.74%	66.92%	71.01%	71.34%	75.60%

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

** LCR became a new regulatory requirement in 2018.

*** Total capital of Conexus in 2019 consists of amounts held in membership shares and member equity accounts of \$17.30 million, accumulated other comprehensive income of \$0.30 million, and retained earnings of \$533.63 million. This differs from the definition of total capital used by the Credit Union Deposit Guarantee Corporation (CUDGC) which amounts to \$545.75 million (2018 - \$515.95 million).

Financial Position Review

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

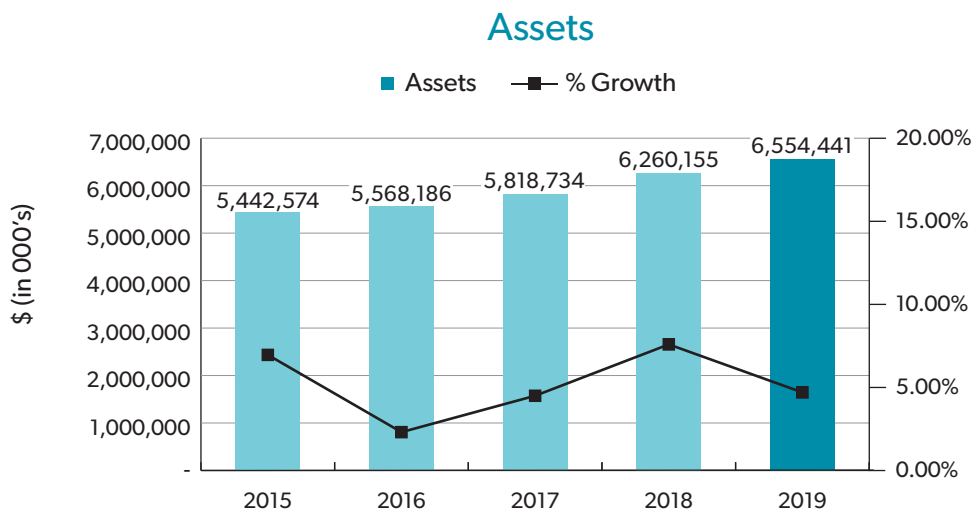
Overview

Total funds under management ended 2019 at \$8.66 billion, up from \$8.26 billion in 2018 and achieving total growth of 4.88% (2018 - 4.79%). Total funds under management include "off-balance sheet" assets under administration, and include: \$1.62 billion in wealth management assets, up considerably from \$1.41 billion in 2018 for an increase of 14.60%; and \$490.24 million in syndicated loans, a decrease of 16.65% (2018 - 8.94%) over 2018 levels of \$588.18 million. Wealth management assets increase is due to an increase in market values and sales of the related assets. The decline in syndicated loans is a result of Conexus' strong liquidity position during the year; resulting in less syndication activity, loan maturities and purchase syndications.

Assets

On-balance sheet assets ended 2019 at \$6.55 billion, compared to \$6.26 billion in 2018, which represented growth of 4.70% (2018 - 7.59%). The lower asset growth in 2019 is due to lower loan growth of 3.20% in 2019 compared to 6.64% in 2018 given softer economic conditions in the Province.

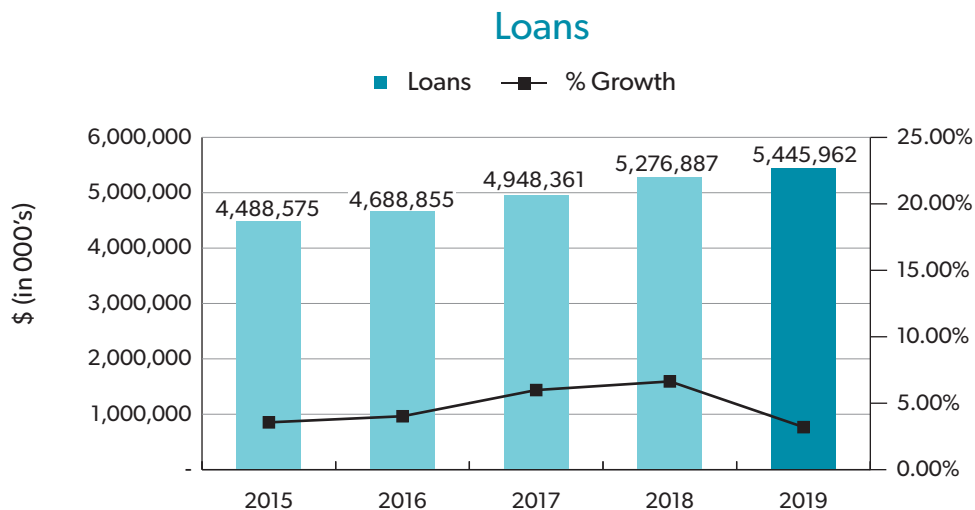
The following illustrates Conexus' growth in on-balance sheet assets over the past five years.



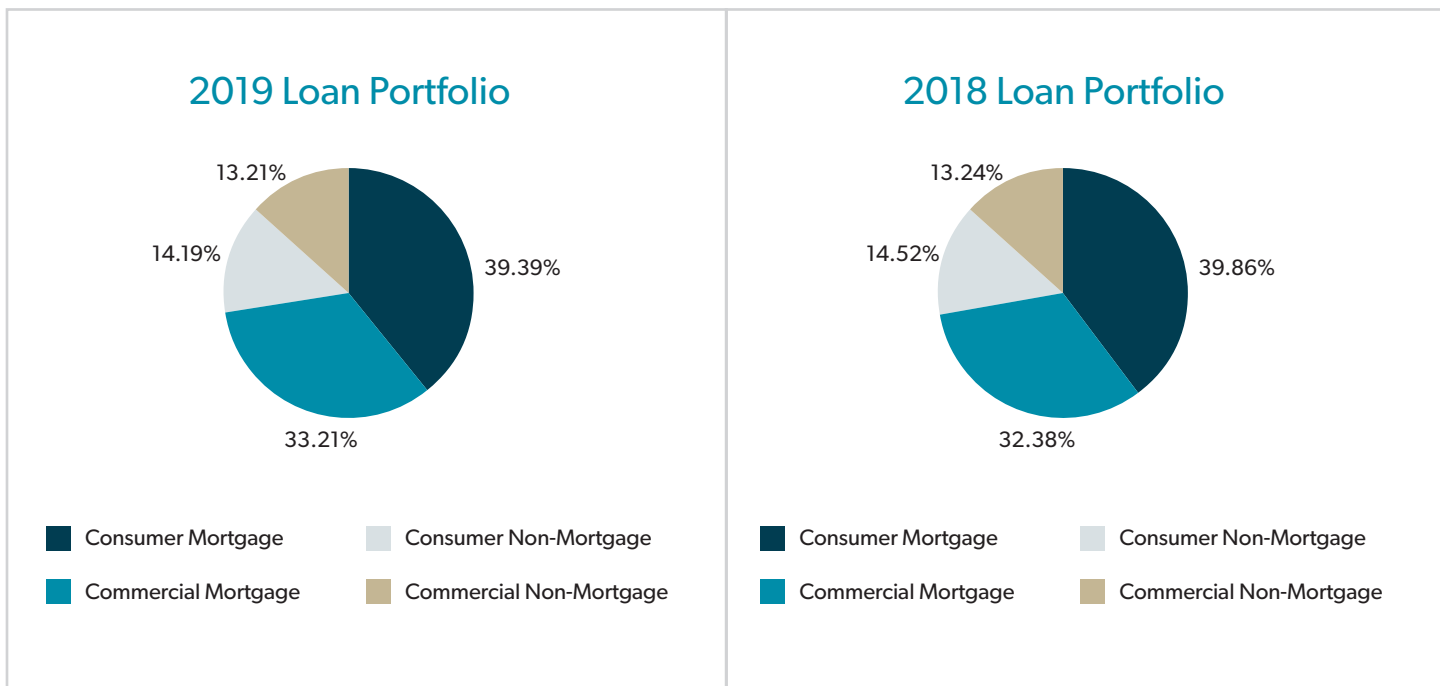
Loans

Loans accounted for 83.09% of total assets, and amounted to \$5.45 billion as of December 31, 2019, representing an increase of 3.20% over the previous year's balance of \$5.28 billion. Lower loan growth in 2019 relative to prior periods, is in large part due to a weaker residential housing market in the Province and thereby lower mortgage demand.

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



A significant portion of Conexus' loan portfolio continues to consist of stable, low-risk consumer residential mortgages. Loan allocation, expressed as a percentage of the total loan portfolio, to the consumer mortgage portfolio decreased slightly from 39.86% in the previous year to end 2019 at 39.39%. Loan allocation to the commercial sector increased over previous year from 45.62% in 2018 to end 2019 at 46.42%.



Residential mortgages

A large portion of Conexus' lending portfolio is comprised of residential mortgages, which are well diversified by borrower. This portfolio ended 2019 at \$2.14 billion representing 39.39% of Conexus' total loans (2018 - \$2.10 billion representing 39.86% 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, 2019	December 31, 2018	December 31, 2017	December 31, 2016
Amortization Period				
< 5 years	5%	5%	5%	5%
5- 10 years	9%	8%	7%	7%
10- 15 years	20%	15%	12%	10%
15-20 years	16%	17%	15%	13%
20- 25 years	47%	51%	54%	52%
25- 30 years	3%	4%	7%	13%
> 30 years	0%	0%	0%	0%
Total	100%	100%	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 (CHMC) 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, 2019					
(In thousands of CDN \$)	Insured		Uninsured		Total
Residential mortgages	1,294,295	58%	847,402	38%	2,141,697
HELOC	-	0%	93,605	4%	93,605
Total	1,294,295	58%	941,007	42%	2,235,302
As at December 31, 2018					
Residential mortgages	1,213,512	55%	886,742	40%	2,100,254
HELOC	-	0%	95,839	5%	95,839
Total	1,213,512	55%	982,581	45%	2,196,093
As at December 31, 2017					
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					
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, 2019		December 31, 2018		December 31, 2017		December 31, 2016	
	Uninsured		Uninsured		Uninsured		Uninsured	
	Residential mortgages	HELOC	Residential mortgages	HELOC	Residential mortgages	HELOC	Residential mortgages	HELOC
Weighted average LTV ratio of newly originated for the year	63%	55%	65%	47%	66%	52%	67%	50%

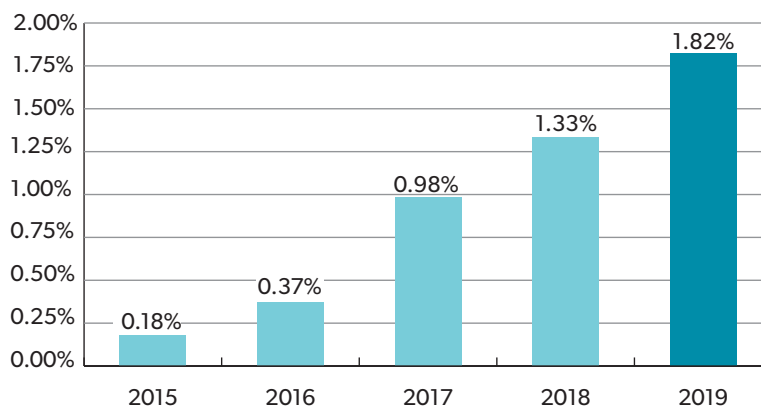
Conexus stress tests its residential mortgage and HELOC portfolios to determine the potential impact of an economic downturn; simulating an increase in defaults and a decrease in housing prices. The stress testing uses a third-party credit default model which uses forward looking economic factors to establish stressed loss levels on a loan by loan basis. Results show that in an economic downturn, which results in delinquencies well above historical levels and home prices well below historical LTV ratios, Conexus has a strong capital position that would be sufficient to absorb residential mortgage and HELOC losses.

Credit Quality

Past due loans

Loans are considered past due when a counterparty is contractually in arrears but where payment in full is expected. Delinquency greater than 90 days was 1.82% for 2019, an increase from 1.33% in 2018. The year over year increase in delinquency of 0.49% was primarily within the commercial loan portfolio, which represents 62.15% of the increase. A prolonged decline in economic conditions in the Province has contributed to the five-year trend as illustrated in the below graph. Despite the year over year increases, delinquency levels remain within acceptable levels relative to the credit union's strong capital position.

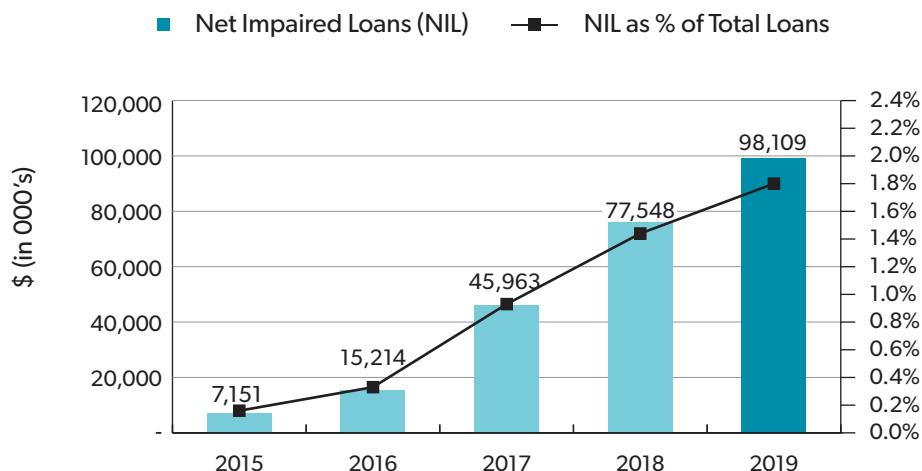
Loan Delinquency Greater Than 90 Days



Net impaired loans

Net impaired loans are considered by management to be uncollectible and are net of individual and estimated loan allowances. It is the amount expected to be realized on the sale of any security on the uncollectible loans. In 2019, net impaired loans increased from the previous year by \$20.57 million to end the year at \$98.12 million (2018 - \$77.55 million). As a percentage of total loans, net impaired loans increased from 1.44% in 2018 to end 2019 at 1.80%. The primary contributor to this increase in impaired loans is the increase in commercial loans greater than 90 days delinquent of \$12.96 million. Smaller increases in delinquent loans occurred for agricultural loans of \$3.50 million and residential mortgages of \$3.31 million.

Net Impaired Loans



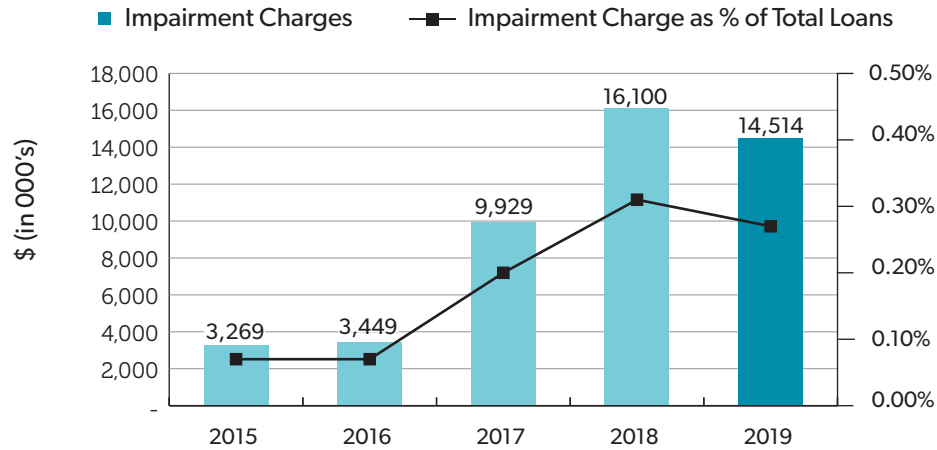
Allowance for credit losses

Conexus monitors its exposure to potential credit risk and measures loss allowances at an amount equal to lifetime expected credit loss (ECL), except for debt investment securities that are determined to have low credit risk at the reporting date and loans where credit risk has not increased significantly since their initial recognition. In particular, management judgement is required in the estimate of whether credit risk of an instrument has increased significantly, inputs into the ECL quantitative model and in the use of forward-looking information (mainly loans). When determining whether the risk of default on a loan has increased significantly since initial recognition, Conexus considers reasonable and supportable information that is relevant and available. This includes both quantitative and qualitative information and analysis, based on the credit union's historical experience, expert credit assessment and considerations of relevant forward-looking information. The total allowance in the year ended at \$21.85 million (2018 - \$16.30 million) and represented 0.40% (2018 - 0.31%) of total loans. The increase of \$5.55 million can be mainly attributed to a small number of commercial loans that became impaired during the year with insufficient security value to cover the potential losses.

Impairment charges

Once allowances for credit losses and write-offs have been assessed, an impairment charge is expensed on the Consolidated Statement of Comprehensive Income. Impairment charges were \$14.51 million in 2019, a decrease of \$1.59 million from the prior year of \$16.10 million. The impairment charges as a percentage of total loans decreased from 0.31% in 2018 to end 2019 at 0.27%.

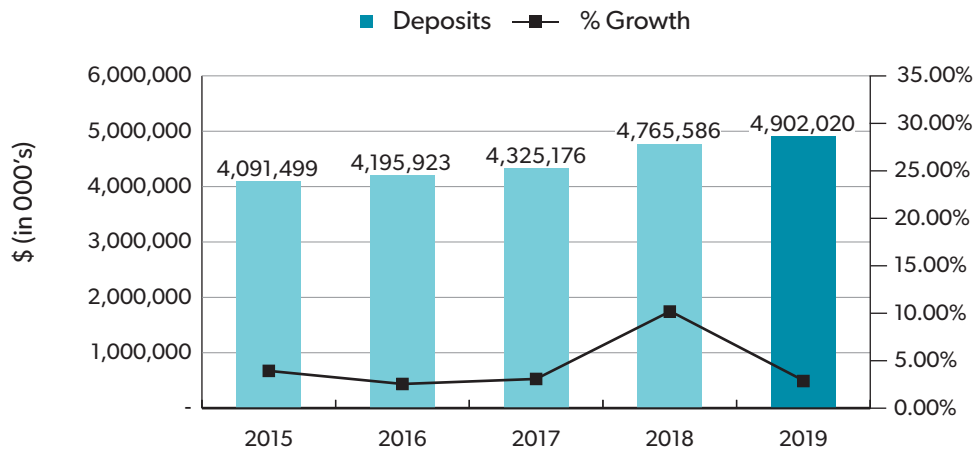
Impairment Charges



Deposits

Deposits ended 2019 at \$4.90 billion compared to \$4.77 billion in 2018, representing growth of 2.86%. Conexus' deposits consist of deposits from both consumer and commercial members.

Deposits



Consumer deposits accounted for 57.86% of total deposits in 2019 (2018 – 58.30%), and commercial deposits accounted for 42.14% of total deposits (2018 – 41.70%). Conexus' deposits are 100% guaranteed by the regulator of credit unions in Saskatchewan, the Credit Union Deposit Guarantee Corporation (CUDGC). In 2019, deposits sourced through third party agents declined \$48.70 million; as Conexus favoured debt facilities and experienced lower loan growth relative to 2018.

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 which represent 57.86% of total deposits in 2019 (2018 – 58.30%). This is followed by commercial deposits at 42.14% of total deposits (2018 – 41.70%).

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 (2018 - \$95 million) and \$7 million in U.S. funds (2018 - \$nil). SaskCentral is a wholesale financial services co-operative that provides clearing, settlement and liquidity management services to its member owners – the Saskatchewan credit unions. Additionally, Conexus has a credit agreement with Desjardins, with a maximum available credit limit of \$150 million (2018 - \$100 million) as well as a term facility to borrow Canadian funds for a term of one, two or three years with a maximum credit borrowing of \$70 million (2018 - \$nil).

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 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 2019, Conexus securitized an additional \$246.26 million in loans (2018 - \$247.04 million) and syndicated \$12.79 million in loans (2018 - \$75.92) as part of its ongoing funding strategies.

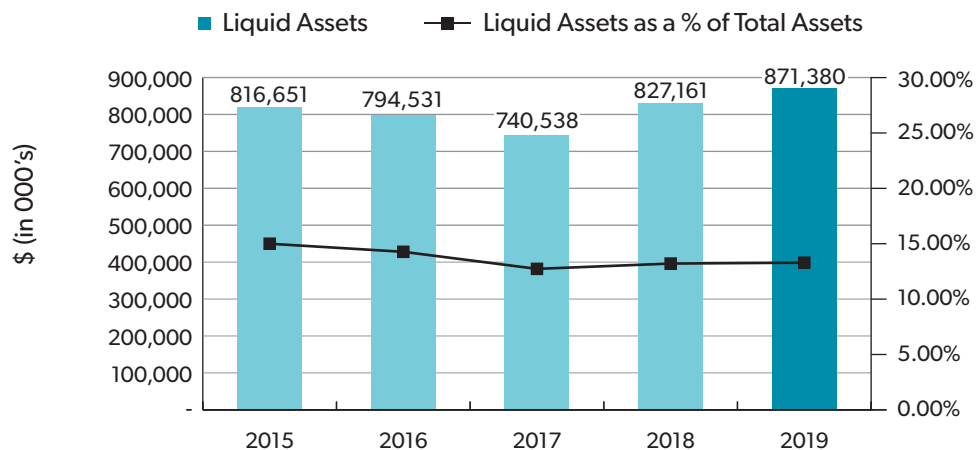
Liquid Assets

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 and statutory liquidity investment securities at SaskCentral. The value of liquid assets increased from \$827.16 million (13.21% of assets) in 2018 to \$871.38 million (13.29% of assets) as of December 31, 2019.

Saskatchewan credit unions are required by the provincial regulator, CUDGC, to maintain 10.00% of their liabilities on deposit with SaskCentral, manager of the Provincial Liquidity Program. Throughout 2019, 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

The primary measures for liquidity adequacy at Conexus include the liquidity ratio, liquid asset ratio (LAR) and liquidity coverage ratio (LCR).

The 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, and redeemable investment securities. In 2019 the liquidity ratio was 265.00% (2018 – 276.00%), well above management's internal target of 150.00%.

The liquid asset ratio (LAR) measures current liquid assets, excluding statutory liquidity investments, as a percentage of total assets. In 2019, the LAR was 5.35% (2018 – 5.40%), well above management's internal target of 3.00%.

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 cash outflows. Regulator standards require credit unions to maintain a minimum liquidity coverage ratio of 100%. In 2019, the LCR was 295.80% (2018 – 242.91%), well 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.

Conexus has been designated as a provincial systemically important financial institution (P-SIFI) and is subject to a capital surcharge of 1.00% of risk-weighted assets. The surcharge requires P-SIFI's to maintain larger capital reserves and a greater ability to absorb losses. The goal of this capital surcharge is to reflect the greater impact that the failure of a P-SIFI may have on the provincial financial system and economy. The capital surcharge is periodically reviewed by CUDGC in light of national and international developments.

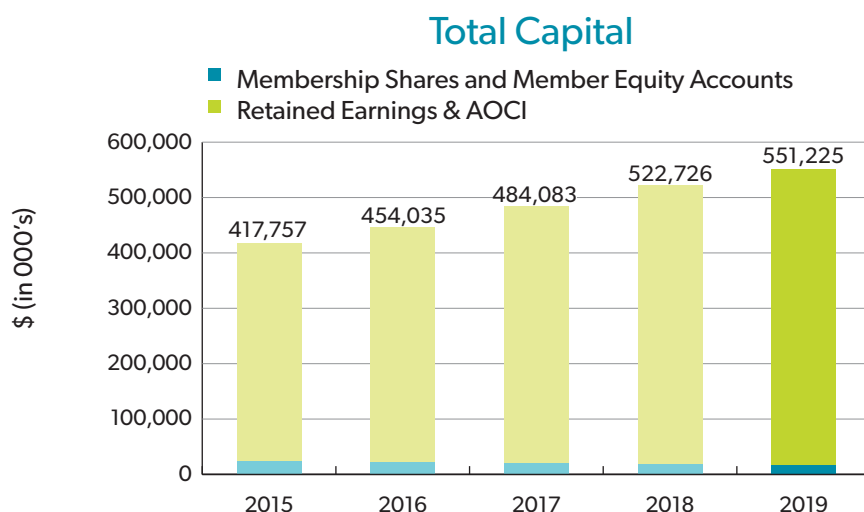
CUDGC currently prescribes four standardized tests to assess the capital adequacy of credit unions: risk-weighted capital ratio (total eligible capital to risk-weighted assets); common equity tier 1 capital to risk-weighted assets; total tier 1 capital to risk-weighted assets; and a minimum leverage ratio (eligible capital to total leveraged assets). The risk-weighted capital ratio is calculated as total eligible capital divided by risk-weighted assets. Achieving minimum regulatory capital levels are of paramount importance to Conexus. Minimum board-level standards are set that either meet or exceed regulatory minimums. Regulatory standards require credit unions designated as P-SIFI to maintain a minimum common equity tier 1 capital to risk-weighted assets of 8.00%, total tier 1 capital to risk-weighted assets of 9.50%, a minimum leverage ratio of 5.00% and a minimum total capital to risk-weighted asset ratio of 11.50%. 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.

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. In addition to board-level minimums for capital adequacy, internal capital targets are set and reviewed annually through the credit union's ICAAP process. Conexus 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.

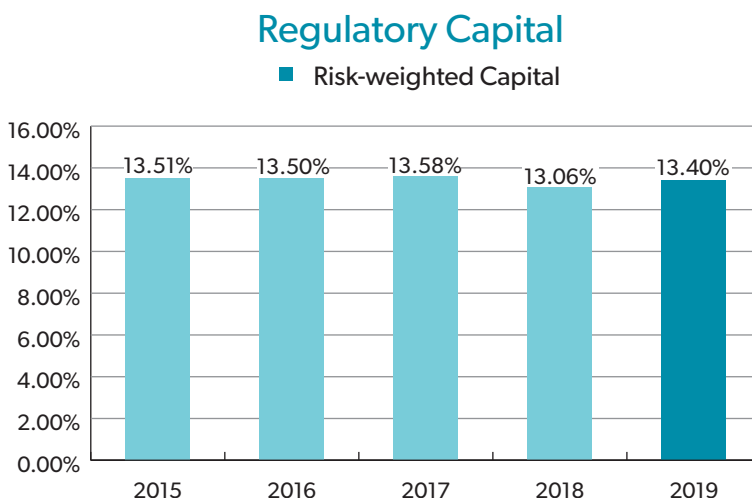
Capital planning is integrated with Conexus' business planning. Conexus' capital plan must demonstrate its ability to meet both board-level capital standards and those established through ICAAP. A capital plan is prepared annually and approved by the Audit and Conduct Review Committee.

Conexus experienced capital growth in 2019, adding to its sound financial position. In 2019, the total capital of Conexus increased by \$28.49 million, from \$522.73 million in 2018 to \$551.22 million. Total capital of Conexus consists of amounts held in membership shares and member equity accounts of \$17.30 million; accumulated other comprehensive income (AOCI) of \$0.30 million; and retained earnings of \$533.63 million. The following chart illustrates the capital composition of Conexus, showing that retained earnings is the main source of capital for Conexus.



Regulatory capital

For the year ending 2019, Conexus' total capital as a percentage of risk-weighted assets was 13.40% (2018 – 13.06%). Common equity tier 1 capital to risk-weighted assets as well as total tier 1 capital to risk-weighted assets was 12.79% (2018 – 12.42%), and the leverage ratio was 8.19% (2018 – 8.05%), all well above the minimum regulatory standards, policy requirements, and those established through the ICAAP.



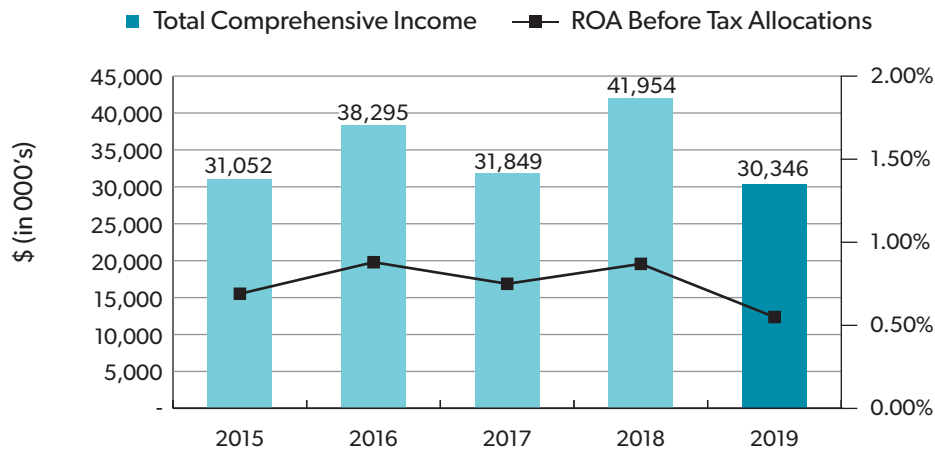
Financial Performance Review

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 2019 was \$30.35 million, a decrease from \$41.95 million in the previous year. For 2019, total annualized return on assets (ROA) before income tax allocations was 0.55%, compared to 0.87% in 2018.

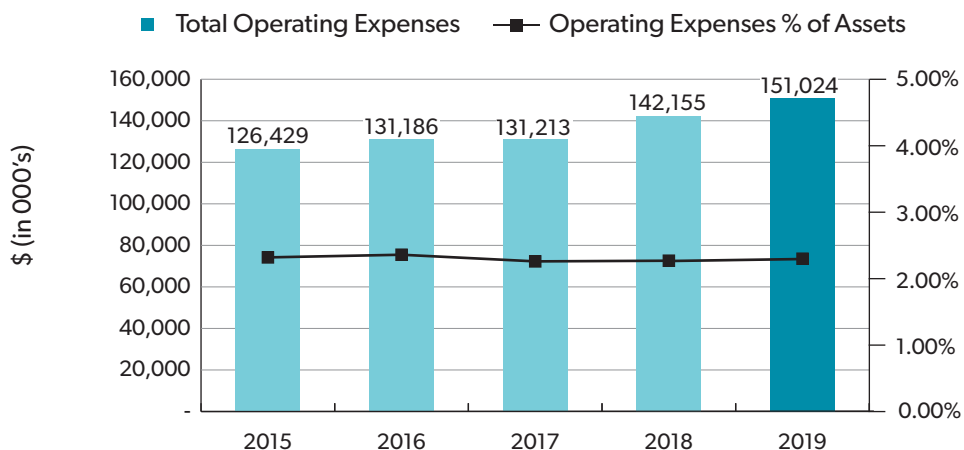
Total Comprehensive Income and ROA



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 investment security impairment charges. Net interest income after impairment charges decreased \$0.21 million between December 31, 2019 and 2018. Expressed as a percentage of total assets, net interest income after impairment charges decreased to 2.19% for 2019 compared to 2.30% in 2018.
- Other income: includes account service fees, loan fees, loan insurance fees, card fees, dividend income and wealth management income. Consolidated other income decreased to \$43.52 million in 2019 from \$52.45 million in 2018. The decline is mainly due to lower earnings attributed to the fair value of investment securities of \$5.82 million and lower dividend income of \$4.21 million.
- Operating expenses: includes various operating costs such as general business, occupancy, organizational, personnel, and member security. Consolidated operating expense increased from 2.27% of assets or \$142.16 million in 2018 to 2.30% of assets or \$151.02 million in 2019. 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

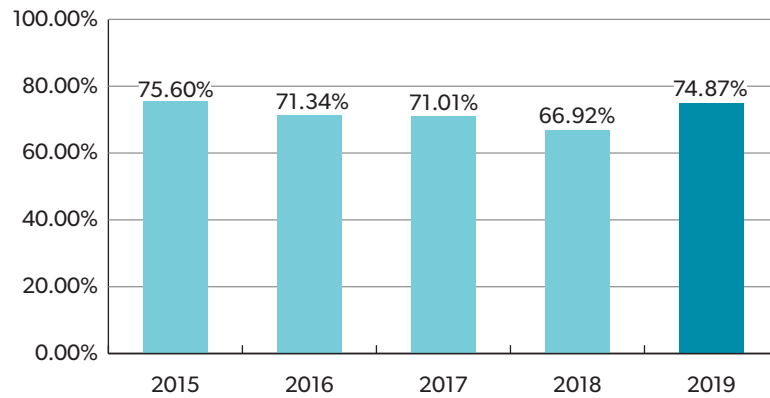


Efficiency

The efficiency ratio measures operating expenses as a percentage of earnings from operations. 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.

The efficiency ratio was 74.87% in 2019 compared to 66.92% in 2018, an unfavourable increase of 7.95%.

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 and Conduct Review 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 are identified and assessed, and mitigation plans 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 (CUDGC), 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.

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.
- **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 engage consumers around our difference and demonstrate the value.
- **Regulatory Perspective on Large Credit Unions** - With the changing regulatory environment for credit unions, increased regulatory burden is being imposed by CUDGC, adding to cost structure and impacting Conexus' ability to compete in comparison to our competitors. In 2018, Conexus was designated as a provincially systemically important financial institution (P-SIFI). Accordingly, Conexus is being held to a higher standard of administrative processes and regulatory rigor including the requirement to hold a higher amount of capital.

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 Vice-President, Strategy, within the governance and strategy area of Conexus. 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.

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 risks

There are no key risks identified in this category.

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 backtesting, 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.

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 risks

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, historically, decreased deposit growth rates. This has created an increased reliance on non-deposit funding instruments, which creates exposure to capital markets.

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.

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 risks

The following key risk has been identified in this category:

- **Credit Risk** - Conexus operates almost exclusively within the province of Saskatchewan, creating high geographic risk characteristics within the credit portfolio. There is a dependence on the economic strength of Saskatchewan as well as the major industries and an increase in bankruptcies and delinquencies has shifted the internal risk rating of the portfolio.

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. A centralized Credit Management Centre is responsible for the creation of appropriate operating policy and the overall management of credit risk.

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 training and reviews are required for specific regulatory requirements and key human resource operating policies and guidelines.

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** - Transformational change requires a focus on developing new skill sets in the workforce for Conexus to successfully execute in a digital-focused, fast-paced and advice based environment. Executing on skill development, and the enablement of employees to deliver on brand promise in an environment where pace of change, resource capacity concerns and an aging demographic increases staff retention risk. A competitive labour market exists for the skills required within the financial industry.
- **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.
- **Operational Process Risk** - Conexus requires policy and process that meets member demand for low friction interaction and supports the empowerment of employees to make at time decisions at the member level while working within Conexus' risk appetite. To achieve these goals, Conexus requires simplified, intuitive policy and processes that leverages technological capabilities to enhance service delivery and employee decision-making capabilities.
- **Technology Platform** - Conexus's technology infrastructure and architecture enablement must drive business value through our ability to leverage and secure data while building strong partnerships. Without modern enterprise integration and internal cohesion, the workforce remains strained by inefficient processes that require a vast amount of application knowledge.

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.