Financial Well-being

Management Discussion and Analysis

2018
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, 2018 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, 2018, and should be read together with those documents. The MD&A includes information up to February 8, 2019. Unless otherwise indicated, all amounts are expressed in Canadian dollars. Amounts for 2014, 2015, 2016, 2017 and 2018 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
- 2018 economic and financial services conditions
- Economic and financial outlook for 2019

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

2018 Economic and Financial Services Conditions

In 2018 the global economy is forecast to have grown 3.7%, up from 3.6% in 2017. Chinese and Eurozone indicators are slowing but growth in the United States (U.S.) has been strong throughout 2018.

The U.S. economy had a strong year of growth. Real GDP slowed in the fourth quarter but still came in at 2.5% year over year for 2018. Consumer spending, which accounts for more than two-thirds of U.S. economic activity, advanced at 2.6% year over year as consumer sentiment increased over the course of the year. The unemployment rate declined throughout 2018 and ended the year at 3.9%. Steady job growth, rising wages, and rising house prices, are helping support the U.S. economy. Against a slowing economic backdrop toward the end of the year, the U.S. Federal Reserve decided to increase the federal funds rate for a fourth time while signalling a slower pace of hikes in 2019.

The Canadian economy is forecast to have grown 2.1% in 2018, which is down from 3.0% in 2017. Overall housing prices have decreased -0.3%, but the economy had been performing well, it has forced the Bank of Canada to raise rates three times in 2018. Headline inflation averaged 2.3% throughout 2018, and the Bank of Canada's core measure was 1.5% on average. Both measures fell within the Bank's target range of 1.0% to 3.0% and trended downward over the last half of the year. The unemployment rate also trended down to 5.6% over the course of the year.

It is estimated that Saskatchewan's economy grew 1.6% in 2018, down from 2.3% in 2017. Growth in 2018 was supported by slightly higher commodity prices through the first part of the year. In the last half of the year, commodities became a drag as oil prices crashed, uranium production stayed low and potash is recovering very slowly. The health of the province's labour market stayed poor as unemployment came in at 6.1%, the second highest rate outside the Maritimes. On the retail sales front, growth increased 0.9% compared to 3.8% last year.

Yields on government bonds in Canada increased during the first half of 2018 due to increased economic growth and inflation expectations. These rates came down in the last quarter as oil prices tumbled and the economic outlook slowed. Short-term interest rates increased as the Bank of Canada increased the overnight rate three times in 2018. It is expected that the Bank of Canada will continue to increase the overnight rate, albeit more slowly, throughout 2019 due to more subdued growth prospects.

Economic and Financial Outlook for 2019

The outlook for the global economy is expected to slow in 2019 with growth projected at 3.5%. Current economic conditions suggest that the U.S. will lead advanced economies in 2019 with growth forecast at 2.3%. The U.S. Federal Reserve is expected to raise rates two times in 2019 due to a slowing, but still growing economy, and rising inflation.

Economists forecast the Canadian economy to grow 2.1% in 2019. These forecasts have been revised downward given the slowing growth outlook for the U.S., U.K. and Chinese economies, along with increased headwinds from trade wars. Economists are forecasting the Bank of Canada to raise the overnight rate two more times in 2019 with caveats on risk to the downside due to global trade uncertainty.

Saskatchewan's economy is expected to grow from an estimated 1.6% in 2018 to 2.0% in 2019. Saskatchewan's economic growth outlook has dimmed as commodity prices dropped toward the end of the year. Forecast was calling for the province to be in the top three for economic growth in 2019. Now, however, it is expected to rank below average for both 2018 and 2019 as ripple effects from the last oil price crash spread. Overall, Saskatchewan's economy is expected to do marginally better in 2019 due to normal agricultural conditions, a recovery in housing, potash production stabilizing and a slight recovery in oil prices. These positive factors are expected to be offset by continued weakness in uranium mining, declining business investment and generally weak employment growth.

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 2018 plan. Actual results for 2018, 2017, 2016, 2015 and 2014 have also been included for comparison. On January 1, 2018, Conexus implemented the new accounting standard *IFRS 9, Financial Instruments* (IFRS 9). As permitted, results from prior year within the MD&A were not restated and presented using the previously enacted accounting standard *IAS 39, Financial Instruments: Recognition and Measurement* (IAS 39). Therefore, assets, loans and advances, credit quality, risk-weighted capital and profitability measures may not be comparable to prior years. For further details on the impacts of the adoption of IFRS 9, refer to Note 26 of the consolidated financial statements.

Financial Management

(In thousands of CDN $)	2018 Actual	2018 Plan	2017 Actual	2016 Actual	2015 Actual	2014 Actual
Growth						
Assets	6,260,155	6,210,517	5,818,734	5,568,186	5,442,574	5,088,252
Asset growth	7.59%	6.73%	4.50%	2.31%	6.96%	8.31%
Deposits	4,765,586	4,626,264	4,325,176	4,195,923	4,091,499	3,936,830
Deposit growth	10.18%	6.96%	3.08%	2.55%	3.93%	2.33%
Loans and advances	5,276,887	5,206,170	4,948,361	4,668,855	4,488,575	4,334,073
Loans and advances growth	6.64%	5.21%	5.99%	4.02%	3.56%	9.40%
Credit quality						
Delinquency greater than 90 days	1.33%	1.14%	0.98%	0.37%	0.18%	0.20%
Net impaired loans and advances	76,039	48,620	45,963	15,214	7,151	6,219
Allowance for credit losses	16,259	7,550	8,756	3,270	3,104	4,282
Loan impairment charges	16,100	8,089	9,929	3,449	3,269	4,268
Liquidity management						
Liquid assets *	827,161	814,648	740,538	794,531	816,651	612,636
Investment securities	674,241	857,885	650,669	679,229	687,505	619,955
Liquidity coverage ratio (LCR) **	242.91%	100%	112.12%	n/a	n/a	n/a
Liquid assets as a % of total assets	13.21%	13.12%	12.73%	14.27%	15%	12.04%
Capital management						
Risk-weighted capital	13.06%	13.30%	13.58%	13.50%	13.51%	12.97%
Common equity tier 1 capital to risk-weighted assets	12.42%	12.76%	12.94%	12.80%	12.11%	11.45%
Leverage ratio	8.05%	7.93%	8.02%	7.79%	7.68%	7.55%
Total capital ***	522,726	515,620	484,083	454,035	417,757	388,731
Profitability and member return						
Total comprehensive income for the year	41,954	33,542	31,849	38,295	31,052	32,096
Return on assets (ROA) before tax allocations	0.87%	0.79%	0.75%	0.88%	0.69%	0.75%
Efficiency ratio	66.92%	72.87%	71.01%	71.34%	75.60%	74.47%

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

** LCR became a new regulatory requirement in 2018.

*** Total capital of Conexus consists of amounts held in membership shares and member equity accounts ($19.14 million in 2018); accumulated other comprehensive income (-$1.09 million in 2018); and retained earnings ($504.68 million in 2018). This differs from the definition of total capital used by the Credit Union Deposit Guarantee Corporation which amounts to $515,951 (2017 - $482,172).

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.

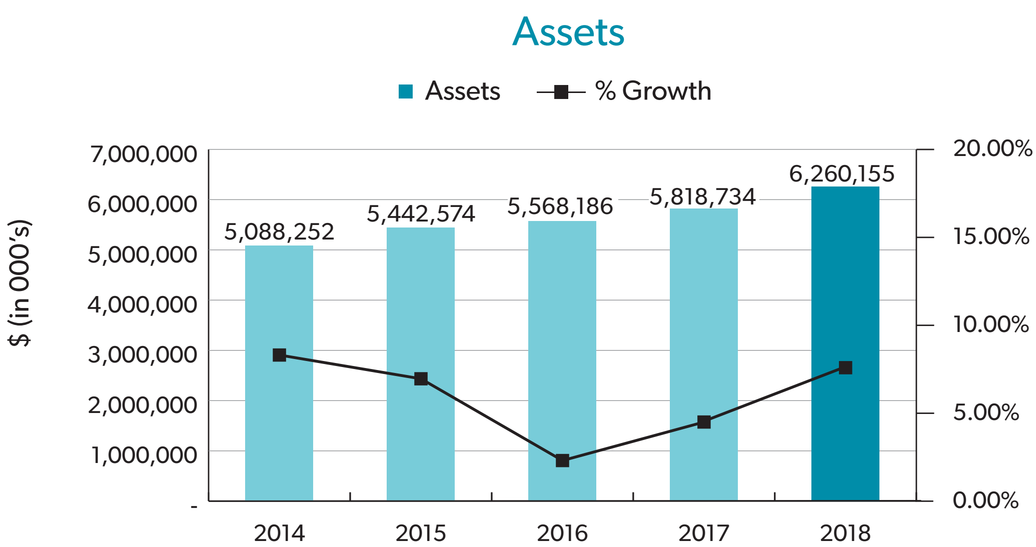
Overview

Total funds under management ended 2018 at $8.26 billion, up from $7.88 billion in 2017 and achieving total growth of 4.79%. Total funds under management include "off-balance sheet" assets under administration, and include: $1.41 billion in wealth management assets, down slightly from $1.42 billion in 2017 or a decrease of -0.43%; and $588.18 million in syndicated loans and advances, a decrease of -8.94% over 2017 levels of $645.90 million. Wealth management assets decrease is due to a decline in market values of the related assets while the decline in syndicated loans is a result of Conexus being in a better liquidity position during the year.

Assets

"On-balance sheet" assets ended 2018 at $6.26 billion, compared to $5.82 billion in 2017, which represented growth of 7.59%. On balance sheet growth increased in 2018 due to a moderate increase in loan demand.

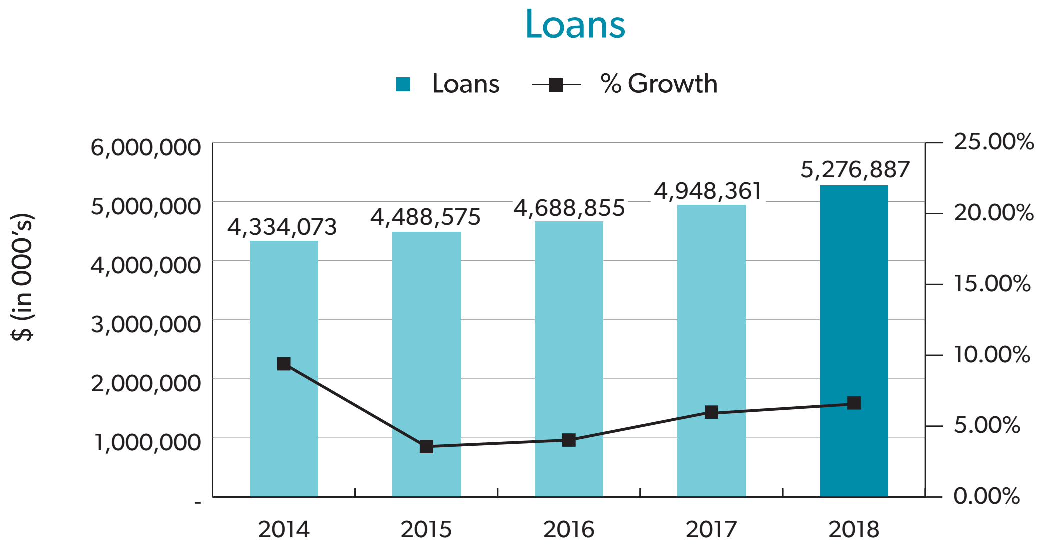
The following illustrates the Credit Union's growth in "on-balance sheet" assets over the past five years.



Loans and advances (loans)

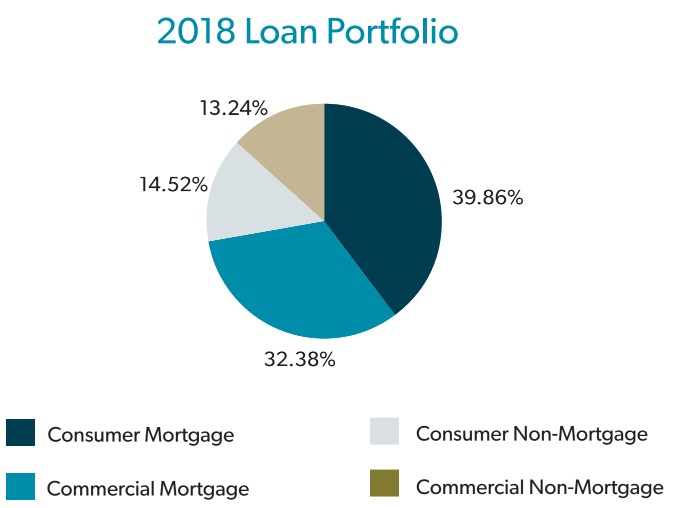
Loans accounted for 84.29% of total assets, and amounted to $5.28 billion as of December 31, 2018, representing an increase of 6.64% over the previous year's balance of $4.95 billion.

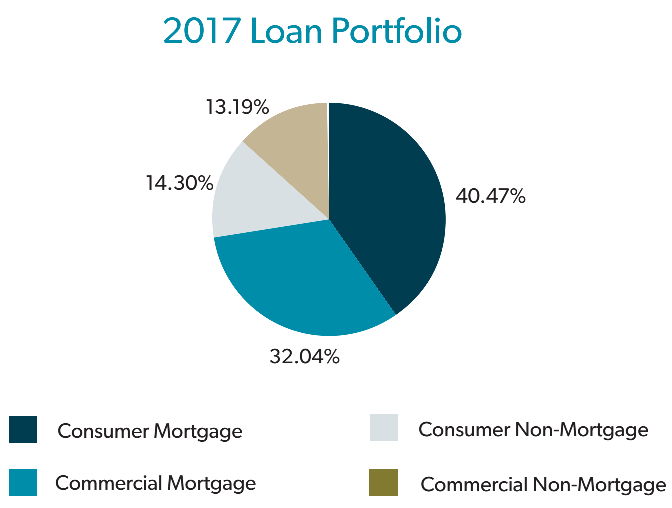
The following illustrates Conexus' loans and advances growth over the last five years.



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 portfolio decreased slightly from 40.47% in the previous year to end 2018 at 39.86%. Loan allocation to the commercial sector increased slightly over previous year from 45.23% in 2017 to end 2018 at 45.62%.

On January 1, 2018, Conexus purchased a portfolio of credit card receivables totaling $68.68 million, which were primarily held by members with existing relationships with the credit union. These credit card receivables represented 1.24% of the total loan portfolio of Conexus on December 31, 2018, and are mainly included in the consumer non-mortgage portfolio.





Residential mortgages

A large portion of Conexus' lending portfolio is comprised of residential mortgages, which are well diversified by borrower. These loans ended 2018 at $2.10 billion representing 39.86% of Conexus' total loans (2017 - $2.00 billion representing 40.48% 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, 2018	December 31, 2017	December 31, 2016
Amortization Period			
< 5 years	5%	5%	5%
5- <10 years	8%	7%	7%
10- <15 years	15%	12%	10%
15-<20 years	17%	15%	13%
20- <25 years	51%	54%	52%
25- <30 years	4%	7%	13%
> 30 years	0%	0%	0%
Total	**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 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, 2018				
(In thousands of CDN $)	Insured		Uninsured		Total
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				
(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, 2018 - Uninsured		December 31, 2017 - Uninsured		December 31, 2017 - Uninsured	
	Residential mortgages	HELOC	Residential mortgages	HELOC	Residential mortgages	HELOC
Weighted average LTV ratio of newly originated for the year	65%	47%	66%	52%	67%	50%

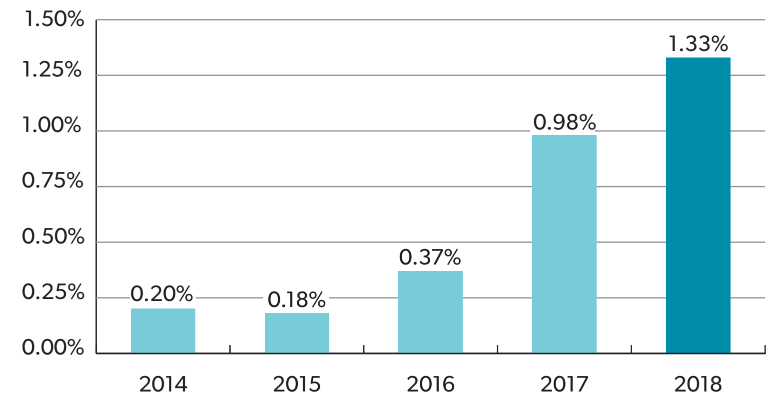
Conexus stress tests our residential mortgage and HELOC portfolios to determine the potential impact of an economic downturn, which results in an increase in defaults and a decrease in housing prices. The stress testing uses historical delinquency information over the last 10 years. Conexus results show 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

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 1.33% for 2018, an increase from 0.98% in 2017. The increase in delinquency was primarily due to a small number of commercial loans (with balances greater than $1 million) being delinquent on December 31, 2018. Despite the year over year increase, delinquency levels remain within acceptable levels relative to the credit union's capital.

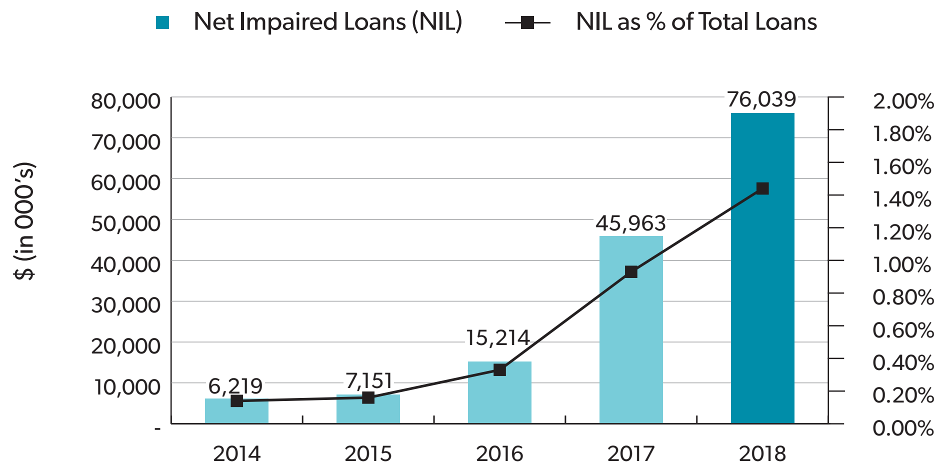
Loan Delinquency Greater Than 90 Days



Net impaired loans and advances

Net impaired loans are loans and advances considered by management to be uncollectible and are net of individual and estimated loan allowances. It is the amount expected to be realized on the sale of any security on the uncollectible loans and advances. In 2018, net impaired loans and advances increased from the previous year by $30.08 million to end the year at $76.04 million (2017 - $45.96 million). As a percentage of total loans and advances, net impaired loans and advances increased from 0.93% in 2017 to end 2018 at 1.44%. Of this increase, $19 million is related to the credit union's adoption of IFRS 9 and the resulting change in accounting policy for the recognition of impaired loans. In accordance with the credit union's accounting policy, and as required under IFRS 9, the credit union recognizes loans in excess of 90 days delinquent as impaired - $13 million of the year over year increase is related to the value of loans over 90 days delinquent.

Net Impaired Loans



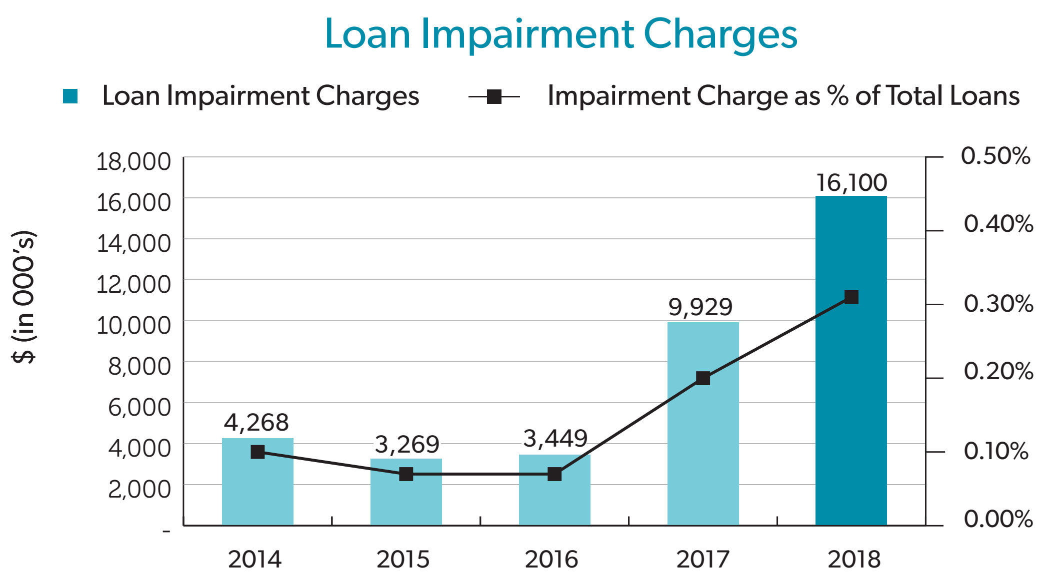
Allowance for credit losses

Upon transition to IFRS 9, Conexus recorded an opening balance adjustment of $2.87 million to allowance for credit losses, for an IFRS 9 total opening balance of $11.63 million. IFRS 9 replaced the 'incurred loss' model in IAS 39 where loan allowances were recorded based on a loss trigger event of delinquency in excess of 90 days. Under IFRS 9, loan allowances are recorded on all loans at the time of origination based on staging criteria and other factors, resulting in Conexus recording allowances for credit losses earlier and at larger amounts than under IAS 39. For further details on the impacts of the adoption of IFRS 9, refer to Note 26 – Explanation of transition to IFRS 9 of the audited consolidated financial statements.

In 2018, after the IFRS 9 transition adjustment the allowance for credit losses allowance showed an increase for the year of $4.63 million to end the year at $16.26 million. The increase is primarily related to the allowance on credit card receivables in the amount of $2.95 million and is expected to decrease as Conexus enhances processes to manage this newly acquired portfolio.

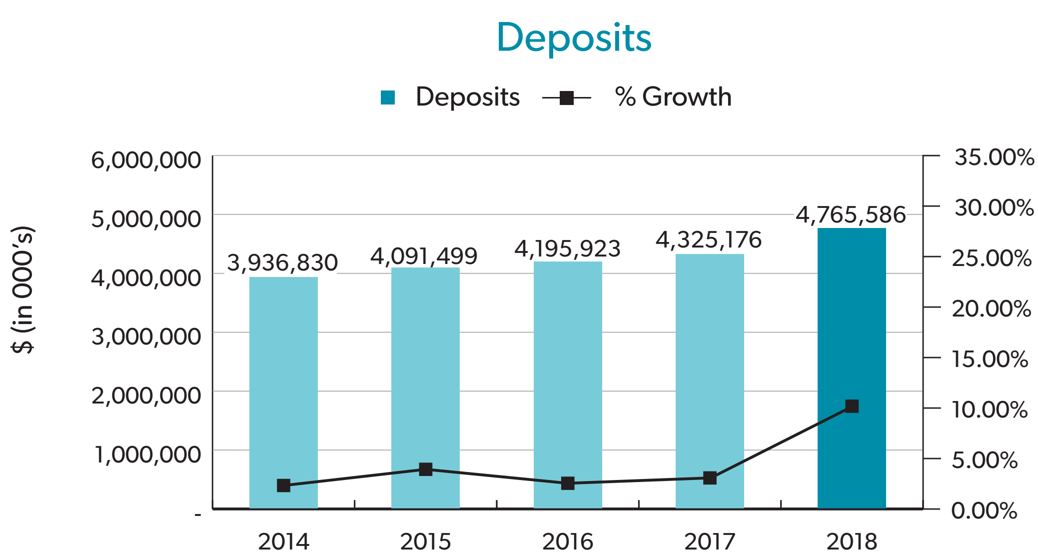
Loan impairment charges

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 were $16.10 million in 2018, an increase of $6.17 million from the prior year of $9.93 million. The new asset class of credit card receivables contributed $5.44 million to this increase; with $1.7 million recognized as a non-operating loss upon purchase of the credit card receivables over the course of the year. Industry impairment charges on credit card receivables are typically higher than other lending portfolios. The loan impairment charges as a percentage of total loans and advances increased from 0.21% in 2017 to end 2018 at 0.31%.



Deposits

Deposits ended 2018 at $4.77 billion compared to $4.33 billion in 2017, representing growth of 10.18%. Conexus' deposits consist of deposits from both consumer and commercial members.



Consumer deposits accounted for 58.30% of total deposits in 2018 (2017 – 61.94%), and commercial deposits accounted for 41.70% of total deposits (2017 – 34.08%). 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 which represent 58.30% of total deposits in 2018 (2017 – 61.94%). This is followed by commercial deposits at 41.70% of total deposits (2017 – 34.08%).

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 Bank (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.

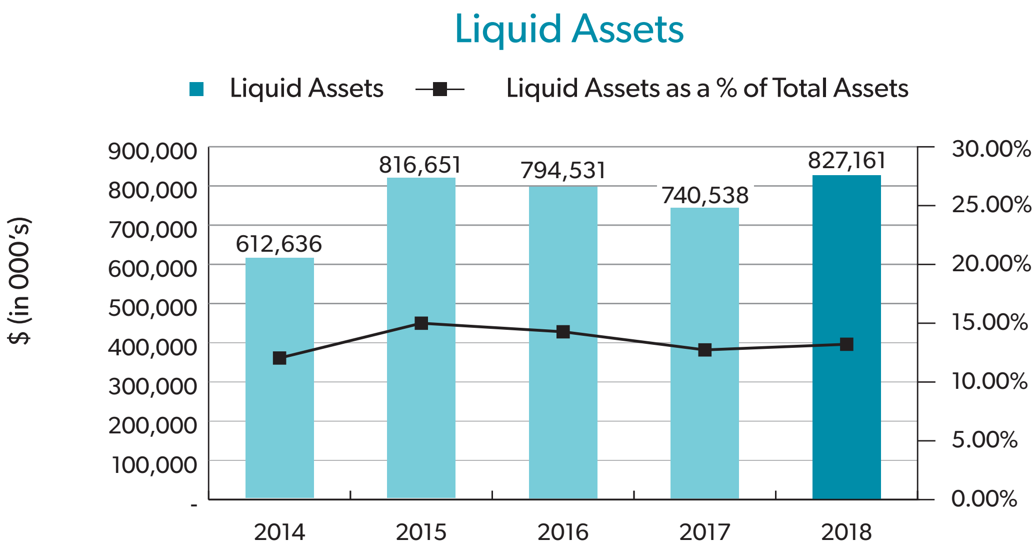
The next source of liquidity for Conexus is the securitization of assets for the purpose of generating funds on the capital markets. Conexus' securitization activities include participation in the Canada Mortgage Bond (CMB) program, the sale of mortgage-backed securities (MBS), and a revolving dealer 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 2018, Conexus securitized an additional $247.04 million in loans and advances (2017 - $228.94 million) and syndicated an additional $75.92 million in loans and advances (2017 - $110.08 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 and statutory liquidity investment securities at SaskCentral. The value of liquid assets increased from $740.54 million (12.73% of assets) in 2017 to $827.16 million (13.21% of assets) as of December 31, 2018.

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 2018, 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.



Operating liquidity
Conexus' liquidity is measured by the liquidity management ratio and the liquidity coverage ratio.

The liquidity management 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 committed credit facilities. In 2017, the ratio was 202%, and in 2018 it was 276%, 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% from CUDGC on January 1, 2017, increasing to 90% in January 2018 and 100% in January 2019. The LCR measure ended 2018 at 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.

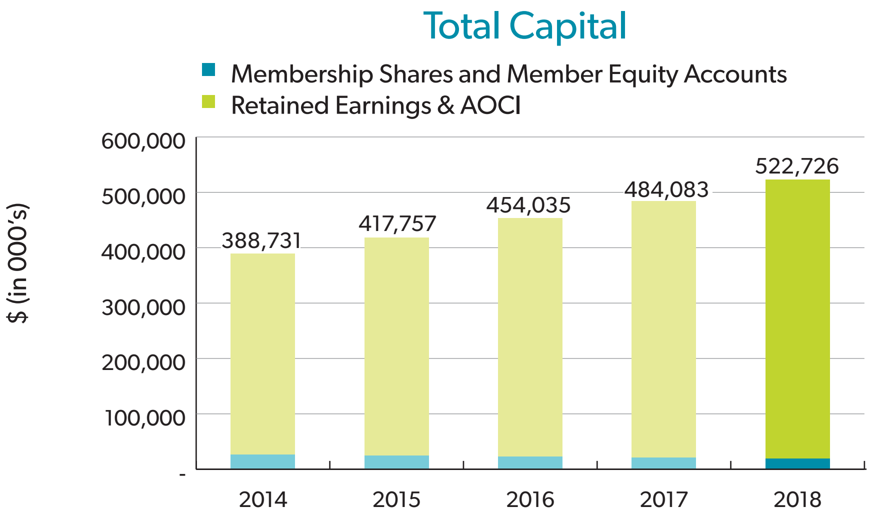
CUDGC currently prescribes four standardized tests to assess the capital adequacy of credit unions: risk-weighted capital ratio (total eligible capital to risk-weighted assets); common equity tier 1 capital to risk-weighted assets; total tier 1 capital to risk-weighted assets; and a minimum leverage 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 process. 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.

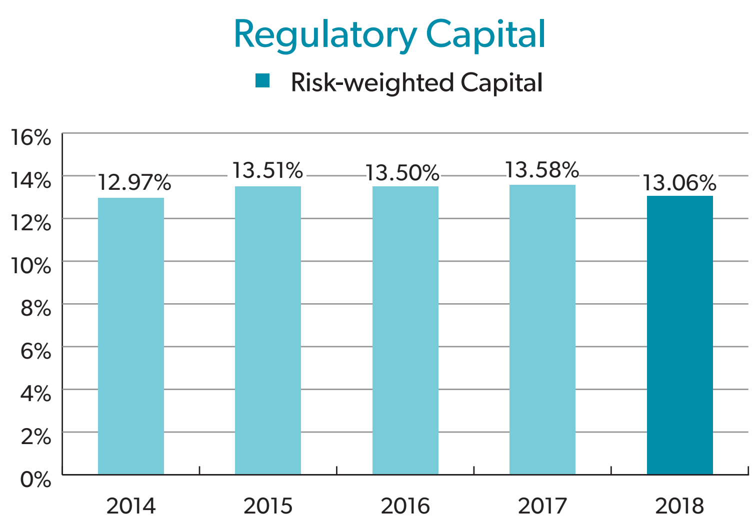
Capital planning is integrated with Conexus' business planning. Conexus' capital plan must demonstrate its ability to meet both board-level capital standards and those established through ICAAP. A capital plan is prepared annually and approved by the Audit and Conduct Review Committee.

Conexus experienced capital growth in 2018, adding to its sound financial position. In 2018, the total capital of Conexus increased by $38.65 million, from $484.08 million in 2017 to $522.73 million. Total capital of Conexus consists of: amounts held in membership shares and member equity accounts ($19.14 million in 2018); accumulated other comprehensive income (AOCI) (($1.09 million) in 2018); and retained earnings ($504.68 million in 2018). 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 2018, Conexus' total capital as a percentage of risk-weighted assets was 13.06% (2017 – 13.58%). Common equity tier 1 capital to risk-weighted assets as well as total tier 1 capital to risk-weighted assets was 12.42% (2017 – 12.94%), and the leverage ratio was 8.05% (2017 – 8.02%), all well above the minimum regulatory standards, policy requirements, and those established through the ICAAP.

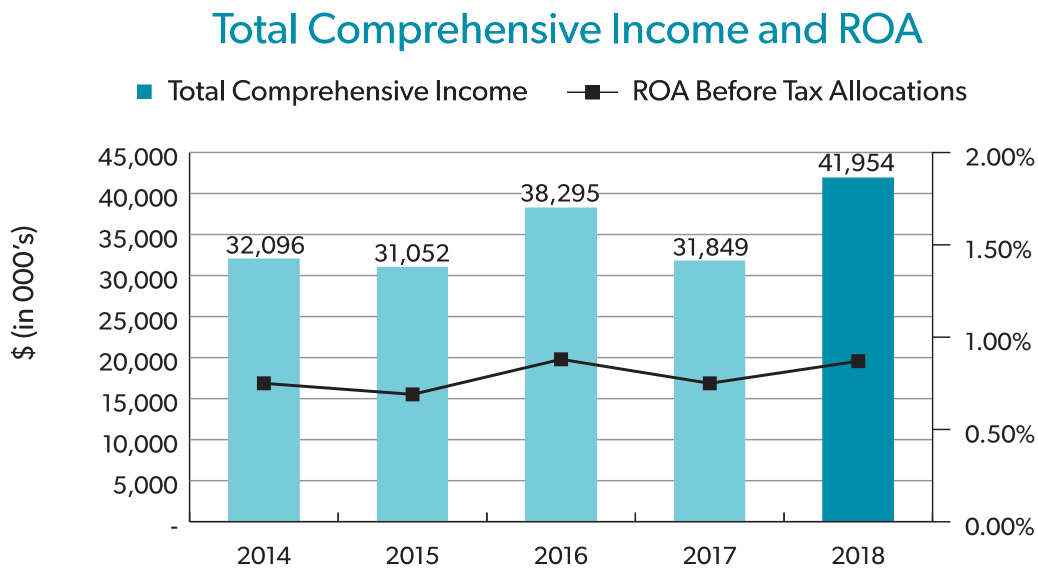


Financial Performance Review

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.

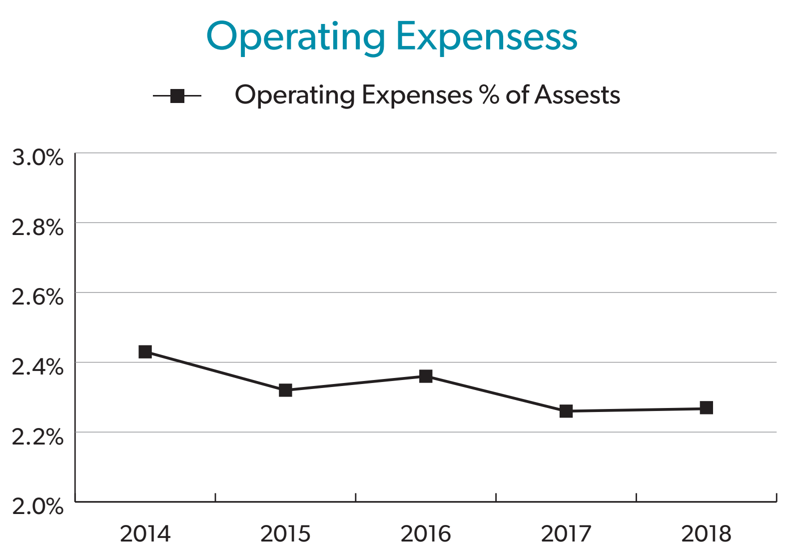
Profitability

Total comprehensive income for the year was $41.95 million, an increase from $31.85 million in the previous year. For 2018, total annualized return on assets (ROA) before income tax allocations was 0.87%, compared to 0.75% in 2017.



Total comprehensive income is comprised of the following items:

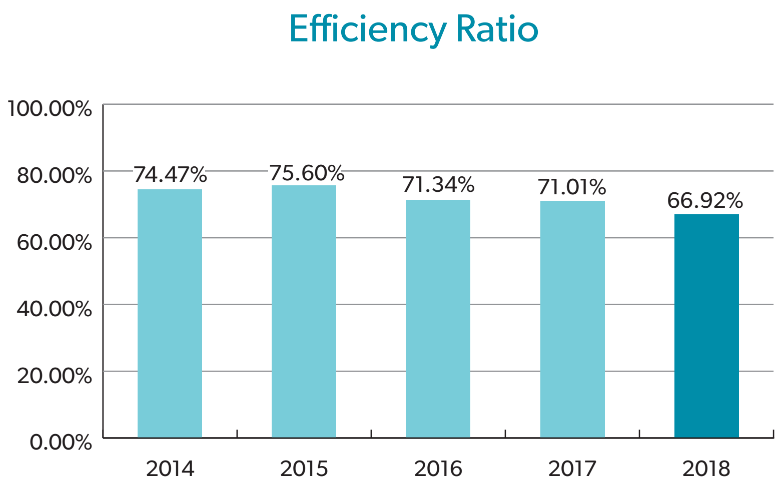
- Net interest income after impairment charges: consists of total interest income less total interest expenses while factoring in any loans and advances and investment security impairment charges. Net interest income after impairment charges increased $14.35 million between December 31, 2018 and 2017. Expressed as a percentage of total assets, net interest income increased moderately to 2.30% for 2018 compared to 2.23% in 2017.
- Other income: includes account service fees, loan fees, loan insurance fees, card fees, dividend income and wealth management income. Consolidated other income increased to $52.45 million in 2018 from $45.32 million in 2017.
- Operating expenses: includes various operating costs such as general business, occupancy, organizational, personnel, and member security. Consolidated operating expense from continuing operations increased in dollar value and increased marginally as a percentage of assets, from 2.26% of assets or $131.21 million in 2017 to 2.27% of assets or $142.16 million in 2018. A large portion of the increase relates to credit card production fees of $3.4 million and credit card program fees of $1.1 million on the newly acquired credit card portfolio. 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.



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 and loan impairment charges.

The efficiency ratio was 66.92% in 2018 compared to 71.01% in 2017, a favourable decrease of 4.09%.



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 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.

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 consumer's 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 of 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
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).

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.

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 alternate 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** - 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 slowdown experienced in the Saskatchewan economy over the past several years, combined with the shift towards a rising interest rate environment is impacting members' ability to manage their service requirements, resulting in an increase in delinquencies, bankruptcies and loan losses.

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 labor market exists for the skills required within the financial industry.
- **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.
- **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 process that leverages technological capabilities to enhance service delivery and employee decision-making capabilities.

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.