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2018 Management's Discussion & Analysis

Management's Discussion & Analysis

This Management Discussion & Analysis ("MD&A") is provided to assist Members with interpreting DUCA's results of operations and financial condition for the fiscal year ended December 31, 2018, as compared to December 31, 2017. The MD&A should be read in conjunction with the audited financial statements, which have been prepared in accordance with International Financial Reporting Standards ("IFRS"). Effective January 1, 2018, DUCA adopted a new standard, IFRS 9: Financial Instruments ("IFRS 9"). Comparative periods have not been restated. Differences in the carrying amounts of financial assets and liabilities resulting from the adoption of IFRS 9 are recognized in retained earnings as at January 1, 2018. Accordingly, certain prior year figures may not be comparable. All amounts in the MD&A are expressed in Canadian dollars.

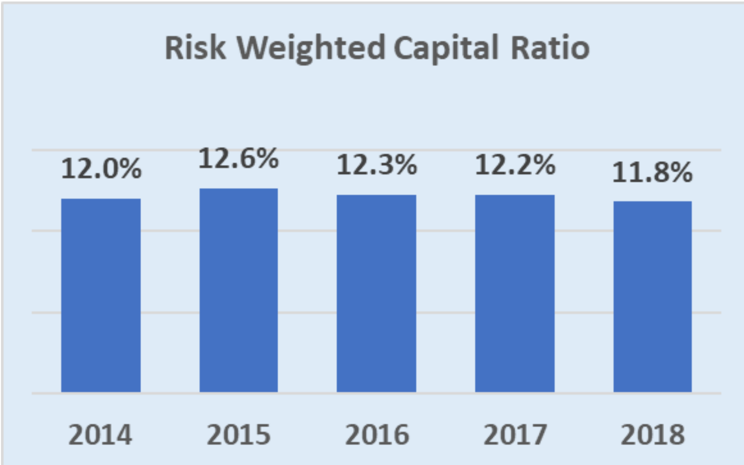
Caution Regarding Forward-Looking Statements

This MD&A may include forward-looking statements which by their very nature require management to make assumptions and involve inherent risks and uncertainties. Forward-looking statements are typically identified by the words "believe", "expect", "anticipate", "intend", "estimate", "may increase", "may impact", and other similar expressions, or future or conditional verbs such as "will", "should", "would" and "could". Several important factors, many of which are beyond management's control, could cause actual future results, conditions, actions or events to differ materially from the targets, projections, expectations, estimates or intentions expressed in forward-looking statements. These factors include, but are not limited to, changes in general economic conditions in Canada, particularly those in Ontario; legislative or regulatory developments; changes in accounting standards or policies; and DUCA's success in anticipating and managing the risks inherent in these factors. Readers are cautioned that the foregoing list is not exhaustive. Undue reliance should not be placed on forward-looking statements as actual results may differ materially from expectations. DUCA does not undertake to update any forward-looking statements contained in this annual report.

DUCA uses several financial measures to assess its performance. Some of these measures are not calculated in accordance with IFRS, are not defined by IFRS and do not have standardized meanings that would ensure consistency and comparability between companies using these measures. They are therefore unlikely to be comparable to similar measures presented by other credit unions and financial institutions and should not be viewed in isolation from or as a substitute for IFRS results.

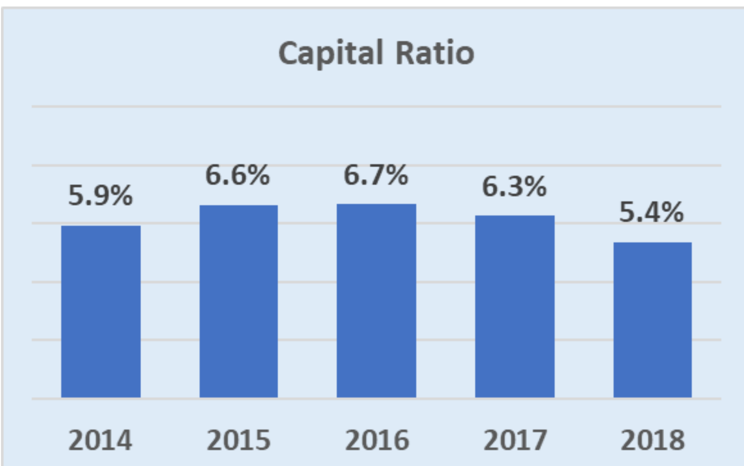
Financial Results Highlights

- Comprehensive income for the year ended December 31, 2018 was $11.0 million compared to $13.0 million for the year ended December 31, 2017.
- Income before patronage, tax and other comprehensive income for the year ended December 31, 2018 was $16.1 million compared to $18.3 million for the year ended December 31, 2017.
- Interest and investment revenue of $111.8 million for the year ended December 31, 2018 was up by 19.5% year-over-year while net interest income of $49.7 million was essentially flat compared to the prior year.
- The provision for (recovery of) credit losses of $(0.3) million was essentially flat year-over-year.
- Non-interest expense of $40.9 million was $2.1 million higher than the prior year.
- Return on average equity ("ROE") was 7.2% for the year ended December 31, 2018 compared with 7.9% for 2017.
- Total assets were $3.374 billion at December 31, 2018 compared with $2.776 billion at the end of 2017 and up 21.6% year-over-year.
- Assets under administration, which include off-balance sheet wealth management assets, were $3.597 billion compared with $3.012 billion in 2017, up 19.4% year-over-year.
- Member Loans increased to $2.899 billion, up 19.7% from $2.422 billion at the end of 2017 primarily resulting from strong performance in residential mortgage growth.
- Member deposits increased to $2.539 billion, up 26.2% from $2.012 billion at the end of 2017. DUCA had two successful Earn More Savings Account campaigns during 2018.
- Securitization balances increased to $633.4 million up 18.0% from $536.8 million at the end of 2017. DUCA will continue to fund a certain portion of its residential mortgage growth through this channel as securitization provides stable access to long-term funding at an attractive cost.
- DUCA returned $1.2 million to its Members in the form of a patronage return. Cumulatively, since 1998, DUCA has returned over $73.7 million to its Members in Class A dividends and patronage returns. Cumulatively, since 2017, DUCA has paid a total of $2.5 million in Class B dividends to holders of Class B investment shares.
- Regulatory capital ratio was 5.4% at December 31, 2018 compared with 6.3% at the end of 2017. The regulatory minimum requirement is 4.0%.
- The Risk-Weighted capital ratio was 11.8% at December 31, 2018 compared with 12.2% at December 31, 2017. The regulatory minimum requirement is 8.0%.



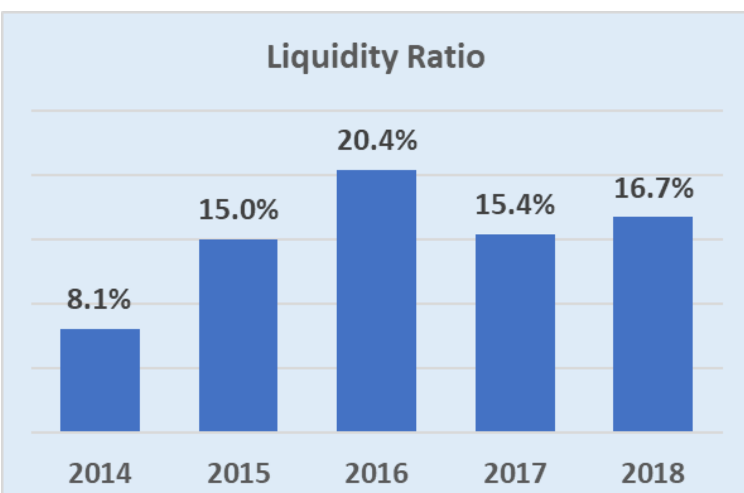
The **Risk Weighted Capital Ratio** is the ratio of regulatory capital divided by risk weighted assets, expressed as a percent. Risk weighted assets is the sum of the absolute value of assets in specified categories multiplied by a corresponding percent, varying between 0% and 100% depending on the risk attributed to each category.

DICO requires a minimum risk weighted capital ratio of 8.0%. DUCA's Board of Directors has established a minimum ratio of 10.5%. The capital ratio was 11.8% in 2018 compared with 12.2% in the prior year. The reduction from 2017 is primarily resulting from balance-sheet growth.



The **Capital Ratio** is the ratio of regulatory capital divided by total assets.

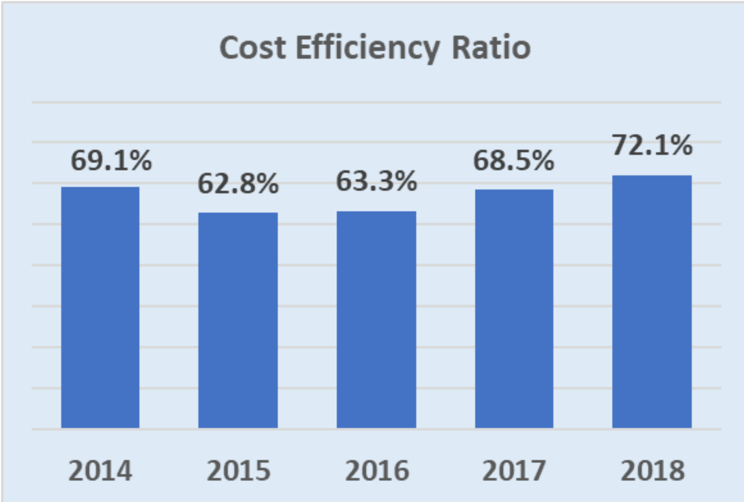
DICO requires a minimum capital ratio of 4.0%. DUCA's Board of Directors has established a minimum ratio of 4.8% for 2018. The capital ratio was 5.4% at December 31, 2018 compared with 6.3% in 2017. The reduction from 2017 was primarily attributable to asset growth.



The **Liquidity Ratio** is the ratio of total unencumbered liquid assets divided by total deposits and borrowings.

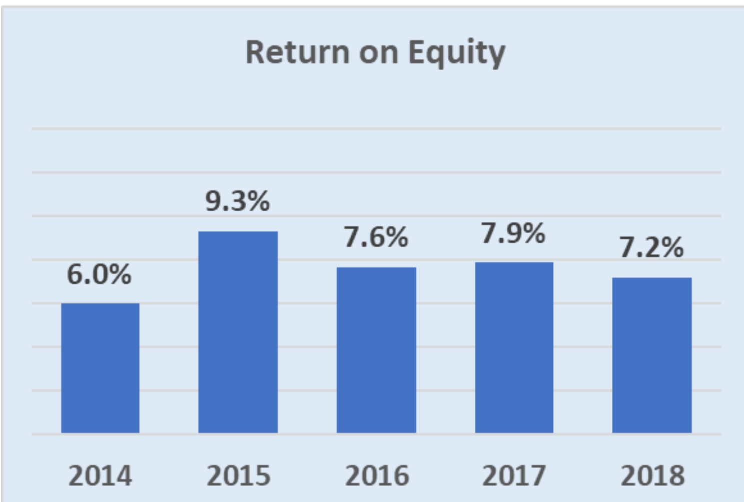
In 2018, DUCA's policy required the liquidity ratio to be a minimum of 10.0%. In 2017, the policy limit was a range of 10.0% to 20.0%. Prior to 2017, the policy limit was a range of 6.0% to 12.0%.

DICO requires the Credit Union to comply with additional liquidity metrics which are discussed on pages 16 - 17.



The **Cost Efficiency Ratio ("CER")** (or **Expense-to-Revenue Ratio**) is a measure of operational efficiency. It is calculated as non-interest expense divided by total revenue, expressed as a percentage.

DUCA's CER was 72.1% for the year ended December 31, 2018, up from 68.5% in the prior year. Net interest income and non-interest income were essentially flat at $56.7 million while operating expenses increased by $2.1 million to $40.9 million. The increase in operating expense reflects focused investment and spending to support planned growth and development of the Credit Union.



The **Return on Equity** (ROE) is calculated as net income as a percentage of average Members' equity.

DUCA's ROE was 7.2% during 2018 compared to 7.9% in 2017 primarily due to lower net income in 2018. Overall revenue was flat while operating expenses increased $2.1 million due to investments in people, marketing and technology to support planned growth and development of the Credit Union.

2018 Financial Performance Review

Net Interest Income

Net interest income is comprised of earnings on assets, such as loans and securities less interest expense paid on liabilities, such as deposits and securitizations. Net interest margin is the ratio of net interest income to average earning assets, expressed as a percentage or in basis points.

The table that follows summarizes the year-over-year changes in our net interest income, product portfolio mix and yields.

($ millions)	2018				2017			
	Average Balance	Interest	Mix	Rate	Average Balance	Interest	Mix	Rate
Cash Equivalents and Investments	392.0	7.2	12.7%	1.8%	362.0	4.5	13.8%	1.4%
Personal Loans	13.0	0.6	0.4%	5.0%	11.0	0.5	0.4%	4.3%
Residential Mortgages	1,772.0	52.5	57.6%	2.8%	1,327.0	35.7	50.5%	2.7%
Commercial Loans/Mortgages	881.0	51.5	28.7%	5.8%	907.0	52.9	34.5%	5.8%
Other	17.0	-	0.6%		20.0	-	0.8%	
Total assets	3,075.0	111.8	100.0%	3.5%	2,627.0	93.6	100.0%	3.6%
Deposits	2,293.0	49.7	74.6%	2.1%	1,948.0	36.7	74.2%	1.9%
Borrowings & Securitization	600.0	12.4	19.5%	2.0%	502.0	8.8	19.0%	1.9%
Other	11.0	-	0.3%		15.0	-	0.6%	
Total liabilities	2,904.0	62.1	94.4%	2.1%	2,465.0	45.5	93.8%	1.9%
Members' equity	171.0	-	5.6%		162.0	-	6.2%	
Total liabilities and Members' equity	3,075.0	62.1	100.0%	2.0%	2,627.0	45.5	100.0%	1.8%
Net Interest Income		49.7		1.5%		48.1		1.8%

Interest and investment income were $111.8 million for the year ended December 31, 2018 compared with $93.6 million for the year ended December 31, 2017. The increase of $18.2 million or 19.4% was primarily a result of higher average interest earning assets, partially offset by overall lower average asset yields. Average yields on loans and investments were 3.5% for the year ended December 31, 2018 compared with 3.6% for the prior year. Lower commercial loan balances resulting from the management of certain large commercial credit exposures and efforts to diversify the commercial loan portfolio, contributed to the overall lower yields compared to the prior year.

Interest expense on deposits was $49.7 million for the year ended December 31, 2018 compared with $36.7 million for the prior year. The interest expense average rate was 2.1% compared with 1.9% for the prior year. The increase of 20 basis points was largely a result of a competitive deposit market and a rising interest rate environment during the year.

Securitization and borrowing costs were $12.4 million, up $3.6 million or 40.9% due to higher levels of securitization balances and borrowings during 2018 and higher funding costs. The overall average funding cost rate of borrowings and securitization increased from 1.9% to 2.0%.

The overall average funding cost rate increased from 1.8% to 2.0% year-over-year, as a result of the aforementioned items.

The overall net interest income rate was 1.5% for the year ended December 31, 2018 compared to 1.8% for the year ended December 31, 2017.

Non-Interest Income

($ millions)	2018			2017		
	Income	Mix	% of average assets	Income	Mix	% of average assets
Loan fees	2.5	35.5%	0.1%	3.5	40.7%	0.1%
Service fees	1.3	18.9%	0.0%	1.4	15.8%	0.1%
Foreign exchange gains and losses	0.3	4.6%	0.0%	0.6	6.5%	0.0%
Wealth Management fees	1.6	22.7%	0.1%	1.8	21.0%	0.1%
Rental Income	0.3	3.9%	0.0%	0.3	3.1%	0.0%
Unrealized (losses) gains on investments	(0.3)	(4.6%)	0.0%	0.5	5.2%	0.0%
Other (non- recurring)	1.3	19.0%	0.0%	0.6	7.7%	0.0%
Total	7.0	100.0%	0.2%	8.7	100.0%	0.3%

Non-interest income, which comprises all revenues other than net interest income decreased by $1.7 million or 19.5% to $7.0 million in 2018.

Lower commercial loan originations and balances resulted in $1.0 million of lower loan fees year-over-year. Wealth fees were lower by $0.2 million as a result of lower assets under management balances.

We also recorded a mark-to-market adjustment on certain investments of $(0.9) million given market performance during the fourth quarter of 2018.

These were partially offset by higher one-time fees of $0.6 million resulting from the settlement of certain delinquent commercial loans during 2018, which is included in other (non-recurring) fees.

Provision for Credit Losses

Effective January 1, 2018, DUCA adopted a new standard, IFRS 9: Financial Instruments. Comparative periods have not been restated. Differences in the carrying amounts of financial assets and liabilities resulting from the adoption of IFRS 9 are recognized in retained earnings as at January 1, 2018. Under IFRS 9, the amount of the provision for Expected Credit Losses ("ECLs") on Stage 3 impaired loans is generally consistent with the specific provision under IAS 39 in prior years, and the amount of the provision for ECLs on Stage 1 and Stage 2 performing loans is generally consistent with the collective provision under IAS 39. DUCA recorded a transition adjustment of ($1.3) million to the opening retained earnings balance for 2018.

($ millions)	**2018**	**2017**
Transition adjustment from IAS 39 to IFRS 9	(1.3)	-
Provision for credit losses	(0.3)	(0.4)
Loan write offs, net of recoveries	1.1	0.3
Total gross loans, December 31	2,898.7	2,422.1
Stage 1 ECL allowance	3.8	N/A
Stage 2 ECL allowance	1.8	N/A
Stage 3 ECL allowance	0.8	N/A
Total allowance for expected credit losses, December 31	6.4	N/A
Collective allowance	N/A	7.2
Specific allowance	N/A	2.0
Total allowance for credit losses, December 31	N/A	9.2

The Credit Union's provision for credit losses was ($0.3) million for the year ended December 31, 2018 compared to ($0.4) million for the prior year.

During 2018, DUCA settled certain commercial loans that had specific provisions allocated in prior years resulting in a net recovery of $0.6 million. DUCA recorded an increase in the provision for credit losses on performing loans of $0.3 million primarily as a result of growth in residential loan balances, partially offset by lower commercial loan balances.

Note 7 to the Financial Statements has additional disclosures with respect to the allowance for credit losses, the movement of ECLs, the portfolio rating of loans by Above Standard, Standard and Below Standard and delinquency aging analysis.

Non-Interest Expense

($ millions)	2018			2017		
	Expense	Mix	% of average assets	Expense	Mix	% of average assets
Salaries and benefits	22.4	54.7%	1.7%	18.2	46.7%	0.7%
Occupancy	3.5	8.6%	0.1%	2.8	7.3%	0.1%
Depreciation and amortization	1.5	3.7%	0.0%	1.4	3.5%	0.1%
Deposit insurance	1.7	4.2%	0.1%	1.8	4.5%	0.1%
Directors and committees	0.5	1.1%	0.0%	0.4	1.1%	0.0%
Other operating and administrative expenses						
Technology	3.6	8.9%	0.1%	2.5	6.5%	0.1%
Marketing	3.0	7.4%	0.1%	2.0	5.2%	0.1%
Professional fees	2.7	6.7%	0.1%	2.3	5.9%	0.1%
Loss on derivative instruments	0.1	0.2%	0.0%	0.0	0.0%	0.0%
Other expenses	1.9	4.5%	0.1%	7.4	19.3%	0.3%
Total other operating and administrative expenses	11.3	27.7%	0.4%	14.2	36.6%	0.5%
Total	40.9	100.0%	1.3%	38.8	100.0%	1.5%

Total non-interest expenses in 2018 were $40.9 million, up $2.1 million or 5.4% from the prior year.

The CER was 72.1% compared to 68.5% for the years ended December 31, 2018 and 2017, respectively. The increase in the CER was primarily attributable to higher non-interest expense resulting from staffing costs as DUCA continues to invest in people and infrastructure to better serve Members, technology and marketing costs.

Salaries and benefits were $22.4 million, up $4.2 million or 23.1% from the prior year. Overall full-time equivalent (“FTE”) employees were 250, up 60 FTEs or 31.6% from the prior year.

Occupancy costs were $3.5 million, up $0.7 million or 25.0% from the prior year. During 2018, DUCA invested in refurbishing certain branches and leased out additional space for its head office staff.

Depreciation and amortization expenses were $1.5 million, up $0.1 million from the prior year primarily as a result of additional spend on computer equipment and the new branch in Mount Albert.

Technology costs increased to $3.6 million, up $1.1 million or 44.0% from 2017. During 2018, DUCA re-negotiated its contract with its banking system service provider resulting in additional fees for development and incurred higher licensing fees and software development for other applications, including the Account Opening System and the Loan Origination System.

Marketing costs increased to $3.0 million, up $1.0 million or 50.0% from 2017 due to a continued focus on DUCA’s digital marketing strategy, brand marketing and the Earn More Savings Deposit campaigns.

In 2017, DUCA established reserves of $2.8 million for certain legal matters. These matters were settled satisfactorily in DUCA’s favour resulting in the reversal of $2.0 million in 2018 in other expenses.

Financial Condition Review

Total assets were $3.374 billion at December 31, 2018 compared with $2.776 billion at the end of 2017 and up 21.6% for the year as a result of higher loan and investment balances.

DUCA's loan growth during 2018 was $476.7 million resulting in an increase in loan balances of 19.7% from 2017's loan balances of $2.422 billion.

Residential mortgage balances increased by $529.4 million or 36.9% (2017 - $306.2 million, 27.1%). DUCA continued to have good success in mortgage originations through its mortgage broker channel. During 2018, net growth in this channel was $391.2 million compared with $285.6 million in 2017.

In October 2017, DUCA expanded its mortgage product suite to include near-prime mortgage originations. DUCA's near-prime mortgage portfolio increased to $341.7 million at the end of 2018 compared to $145.7 million in 2017. The near-prime mortgage portfolio grew by $196.0 million in 2018.

To diversify our retail channels, DUCA launched the mobile-mortgage specialist channel in 2018. The mobile mortgage specialists will meet Members at a time and place that is convenient to the Member and are not restricted to doing business at a branch or during branch hours. Loan growth in this channel was over $50.0 million and DUCA will continue to invest in the channel in 2019.

Our commercial loan balances decreased by $51.2 million or 5.3%. The commercial finance team has been managing down certain large commercial credit exposures and new loan origination has been rebalanced to be less reliant on large commercial and land transactions.

Total loans in arrears decreased to $36.8 million at the end of 2018 compared with $69.7 million at December 31, 2017. The decrease was primarily due to the effective management of certain large commercial credit exposures.

Investments and cash resources totaled $449.8 million at December 31, 2018, up from $334.1 million in 2017. This increase was primarily due to higher cash and investment balances on hand as at December 31, 2018 resulting from the Earn More Savings promotion in place during December 2018.

Member deposits increased to $2.539 billion at December 31, 2018, up 26.2% from 2017. The increase in Member deposits is largely attributable to two successful Earn More Savings campaigns during 2018.

DUCA continued its program of securitizing residential mortgages though Canada Mortgage and Housing Corporation ("CMHC") National Housing Act Mortgage-Backed Securities (NHA MBS) and Canada Mortgage Bond ("CMB") Programs. Securitizing mortgages is an additional funding mechanism and allows DUCA the opportunity to obtain funding at attractive rates compared to other sources, as well as matching the maturity terms of the underlying mortgages. In October 2017, the Department of Finance ("DoF") announced new housing rules including a stress test using the Bank of Canada's 5-year posted fixed rate for all insured mortgages and maximum amortization of 25 years and maximum property value of $1.0 million for low-ratio mortgage insurance and no rentals or refinancings. The new rules have resulted in lower volumes of insured and insurable mortgages, reducing DUCA's overall securitization volumes. While securitization balances increased to $633.4 million, up $96.6 million or 18.0% from the prior year, a smaller portion of our mortgage originations were securitizable because of the changes. DUCA's portion of residential mortgages that have been securitized was 32.2% the end of 2018 compared with 37.4% at the end of 2017.

DUCA's credit facilities to support its operations include an $80.0 million facility with Central 1, a $125.0 million facility (2017 - $75.0 million) with Desjardins and a $14.0 million facility with a Canadian bank. These arrangements provide DUCA with additional borrowing facilities and at the same time enable DUCA to more effectively manage cash flows, liquidity and yield optimization.

DUCA also has a $50.0 million facility with Central 1 for the guarantee of payments on third party Municipalities, Universities, School Boards and Hospital ("MUSH") deposits with DUCA.

None of the facilities were drawn at December 31, 2018 compared to $34.5 million at December 31, 2017.

Regulatory capital was $180.9 million at December 31, 2018 up from $173.8 million at December 31, 2017 driven by net income in 2018 and partially offset by share redemptions and Class B dividends.

DUCA's regulatory capital ratio to total assets was 5.4% at the end of 2018 compared with 6.3% at the end of 2017 and exceeds the minimum of 4.0% stipulated in the Credit Unions and Caisses Populairies Act, 1994 (the "Act").

DUCA's regulatory risk-weighted capital adequacy ratio was 11.8%, down 40 basis points from 12.2% at the end of 2017 but higher than the minimum of 8.0% stipulated in the Act.

Provincial Regulations also require at least 50.0% of a credit union's capital base be comprised of Tier 1 capital. As at December 31, 2018, DUCA's Tier 1 capital represented 94.7% (2017 – 93.5%) of the overall capital base, well in excess of the minimum requirement.

Wealth assets under management decreased from $236.7 million at year-end 2017 to $223.3 million at December 31, 2018. Wealth assets include Mutual Funds, Stocks and Bonds offered through an arrangement with Qtrade Financial Group ("Qtrade") as at December 31, 2017.

On April 3, 2018, Desjardins Group and a partnership comprised of Canada's five provincial credit union centrals (the Centrals) and The CUMIS Group entered into an agreement to merge the businesses of their subsidiaries, Credential Financial Inc., Qtrade Canada Inc. and NEI Investments.

The new entity, Aviso Wealth, is jointly owned by Desjardins and a limited partnership comprised of the Centrals/CUMIS, with each holding a 50.0% stake. The Centrals represent approximately 300 credit unions across Canada. CUMIS is owned jointly by Co-operators Life Insurance Company and Central 1 Credit Union.

As a result of the merger, DUCA entered into a new partnership agreement with Aviso Wealth in April 2018.

Dividends

DUCA's track record of profitability has enabled the payment of patronage, dividends on its Class A shares and Class B investment shares.

The payment track record for the last five years is as follows:

($ millions)	**2018**	**2017**	**2016**	**2015**	**2014**
Patronage return	1.2	1.2	1.2	2.1	2.0
Class A shares dividend	0.8	0.9	0.9	0.9	0.9
Class B shares dividend	1.2	1.3	-	-	-

During 2018, the Board of Directors declared a patronage return of 2.0% (2017 – 2.0%) consisting of bonus interest on Members' deposits and loan interest rebates.

On February 28, 2018, the Board of Directors declared a dividend of 3.0% on the outstanding amount of the Class B shares and a dividend of 2.0% on the outstanding amount of Class A shares to the holders of record at December 31, 2017. The dividends were paid on March 1, 2018.

On February 28, 2019, the Board of Directors declared a dividend of 3.5% on the outstanding amount of the Class B shares and a dividend of 2.0% on the outstanding amount of Class A shares to the holders of record at December 31, 2018. The dividends were paid on March 1, 2019.

DUCA paid over $73.7 million to its Members in Class A dividends and patronage returns since introducing the profit-sharing Patronage program in 1998. DUCA has paid a total of $2.5 million in Class B dividends to holders of Class B investment shares since 2017.

Capital Management

DUCA is committed to a disciplined approach to capital management and maintaining a strong capital base to support the risks associated with its business activities. At all times, DUCA adheres to capital regulatory requirements prescribed by the Deposit Insurance Corporation of Ontario ("DICO").

DUCA's capital management philosophy is to maintain a prudent cushion of equity to ensure ongoing economic stability as well as finance new growth opportunities.

DUCA's capital management framework establishes and assigns the responsibilities related to capital and sets forth both general and specific policy guidelines related to capital management and the reporting mechanisms.

DUCA's Capital Management is a key accountability of the Board of Directors (the "Board") of DUCA. The Board provides oversight and approval of capital management, including the capital plan included in the Annual Operating Plan ("AOP"). The Board regularly reviews DUCA's capital position and key capital management activities.

DUCA's capital requirements are provincially regulated and monitored by DICO for both the minimum regulatory capital and the risk weighted capital approach developed by the Bank for International Settlements ("BIS"). DICO established a minimum capitalization of 4.0% based as a percentage of assets and a minimum capitalization of 8.0% based on a ratio of capital to risk-weighted assets. In addition, at least 50.0% of a credit union's capital base, for meeting the standard, must consist of primary or Tier 1 capital that includes voting share capital, qualifying investment shares, contributed surplus, retained earnings, less intangible assets such as goodwill and deferred income tax assets.

At December 31, 2018, DUCA's capital to asset ratio was 5.4% (2017 – 6.3%), the risk weighted capital ratio was 11.8% (2017 - 12.2%) and the Tier 1 ratio to total capital was 94.7% (2017 – 93.5%).

Capital levels are monitored monthly based on our forecasted financial position, on both capital leverage and risk weighted basis. DUCA's monitoring and forecasting procedures track the expected growth rate in both assets and risk-weighted assets relative to earnings to determine if additional capital is required. These projections also take full account of any future impact of changes in accounting standards.

Risk Management

The Board is accountable for the risk appetite of the Credit Union and for overseeing the Credit Union's management of its principal risks. While the Board delegates accountability for the development and implementation of risk policies and procedures to the Chief Executive Officer ("CEO"), it retains responsibility for ensuring that these policies and procedures remain adequate and comprehensive and that the Credit Union follows them.

Included in this policy are DUCA's Risk Appetite Statements ("RAS") and Enterprise Risk Management Framework ("ERMF") which are integral parts of the Credit Union's overall ability to effectively manage risks. The RAS and ERMF involve the interaction of risk-related activities including oversight, risk assessment, risk quantification, monitoring, reporting, escalation, and risk controls.

DUCA's risk taking activities are undertaken with the understanding that risk taking, and effective risk management are necessary and integral to achieving strategic objectives and managing business operations. However, above all, risk taking activities are guided by the Credit Union's overarching objective of safeguarding commitments made to its Members and stakeholders.

DUCA's ERMF Policy reflects the following risk philosophy:

- DUCA's strategic objectives are established by balancing the requirement to safeguard the commitments the Credit Union has made to its Members and stakeholders, while generating an appropriate risk-adjusted return for our Members;

- The Risk Management function will be part of the management of the Credit Union with risk analysis and risk reporting forming part of the regular activities and on-going responsibility of all those who make decisions;

- All employees are to base business decisions on an understanding of the risk that will be accepted. This applies to transactions, products, planning, relationships with Members or suppliers and any other business activities. Risk management is about how DUCA makes decisions and ensures that all decision makers consider the potential impacts (positive or negative) of those decisions;

- All business activities will align with our Mission, Vision, Values, Code of Conduct and Policies;

- Providing financial services inherently involves the assumption of risk. On this basis, DUCA's business strategy, the effective management and acceptance of risk, and its related risk appetite are closely linked and integral components in business decision making;

- Business strategy choices are evaluated based on appropriate risk/return trade-offs, the serving of Members' best interests and satisfying needs of stakeholders. At the same time, strategic choices must fit within the Credit Union's risk appetite, which also is formulated based on serving Member best interests, satisfying needs of stakeholders, and the appropriate understanding and management of risks;

- The organization will maintain a culture that encourages all staff and the Board to be involved in open, honest, timely and critical discussions of risk;

- DUCA will develop and use a standard set of tools to assist in the identification, analysis, evaluation and reporting of risk.

The Credit Union's Board is accountable for the oversight of risk management that is centred on the "three lines of defense" model:

- 1st Line of Defense – DUCA's first line of defense includes the CEO and business managers. Businesses are ultimately responsible for the risks they assume and for the day-to-day management of the risks inherent in the product, activities, processes, and systems for which they are accountable as well as the execution of risk mitigation practices consistent with risk appetite. Various committees are in place to oversee the day-to-day management of risk.

- 2nd Line of Defense – DUCA's second line of defense consists of the Chief Risk Officer and the Risk Management function. This group provides oversight of risk taking and risk mitigation activities across the enterprise. The Management Risk and Asset Liability Committee ("MRALCO") also provides support to the Executive Leadership Team "(ELT") for overseeing enterprise-wide risk taking and risk mitigation activities.

- 3rd Line of Defense - The third line of defense consists of Internal and External Audits which provide independent assurance that controls are effective and appropriate relative to the risks inherent in the business and that risk mitigation programs and risk oversight functions are effective in managing risks.

Identification and Management of Key Risks

The identification, assessment and management of risk are critical elements of DUCA's ERMF program, both on a day-to-day basis as well as when any new business initiative or activity is undertaken. DUCA manages these risks as part of its risk management activities through the MRALCO.

Our ERMF defines and categorizes risk as outlined below:

Credit Risk	Operational Risk	Capital, Liquidity, and Market Risk	Strategic Risk	Compliance Risk

Credit Risk

Credit risk is the risk of financial loss when a Member or counterparty to a financial instrument fails to meet the contractual obligations of repayment and arises principally from the loan portfolio. DUCA's lending philosophy is established by the Credit Risk Management Policy ("CRMP"). The CRMP provides direction to management relative to:

- Formulating operational credit policies covering eligible purposes of loans, collateral requirements, credit assessment, risk rating and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements;
- Establishing a lending authority structure for the approval and renewal of credit facilities;
- Authorization limits are delegated to the Management Credit Committee ("MCC"), Chief Risk Officer and Risk Management personnel;
- Reviewing and assessing specific and aggregate credit risk;
- Limits in concentrations of exposure to counterparties;
- Compliance with agreed exposure limits. Monthly reports are provided to the MCC and to the Board on the quality of the loan portfolio.

Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed human performance, processes or technology. DUCA is exposed to a broad range of operational risks including talent acquisition, retention, performance and succession, technology/systems failures, fraud/theft/misappropriation of assets, business disruption, information/privacy/fiduciary breaches or failed transaction processing. The failure to manage operational risk can result in direct or indirect financial loss, reputational impact, regulatory censure and penalties, or failure in the management of other risks.

DUCA manages operational risk through its policies, procedures and internal controls related to human resources, information technology development and change management and business operations. Complementing these policies, procedures and internal controls, are teams that focus on the enterprise-wide management of specific operational risks such as financial crime, business continuity/disaster recovery, privacy and confidentiality, vendor management, project management, and information security and information technology governance. These teams have developed specific programs, policies, standards and methodologies to support the management of operational risk.

Capital, Liquidity and Market Risk

1. Capital Risk

   The Internal Capital Adequacy Assessment Process ("ICAAP") provides a framework for evaluating and determining the amount of capital required to manage through unexpected losses arising from adverse economic and operational conditions. Modelling and stress testing, applied to both near- and longer-term planning, forecasting and strategic objectives, is a key component of the ICAAP. The ICAAP includes: calculation of required capital levels based on the financial plan for the upcoming fiscal year, application of stress testing related to key identified risks using sensitivity analysis to determine capital impacts under different scenarios, assessment of internal capital targets for reasonableness relative to the regulatory capital requirements and projection of capital levels over multiple years. The ICAAP is reviewed, approved by the Board, and submitted to DICO annually.

   Application of the ICAAP in 2018 confirmed that DUCA's capital levels are sufficient. The Credit Union does expect higher levels of asset growth in the future and will proactively manage its capital to ensure capital sufficiency on an ongoing basis.

2. Liquidity Risk

   Liquidity is the ability of a credit union to generate or obtain sufficient cash or its equivalents in a timely manner at a reasonable price to meet its commitments as they fall due. Liquidity risk arises from a credit union's potential inability to meet both expected and unexpected current and future cash flow and collateral needs without affecting daily operations or its financial condition. A credit union's obligations, and the funding sources used to meet them, depend significantly on its business mix, balance sheet structure, and the cash flow profiles of its on- and off-balance obligations. These include funding mismatches, market constraints on the ability to convert assets into cash or in accessing sources of funds, and contingent liquidity events, such as finding additional funds for undrawn loan commitments or replacing maturing liabilities.

   The Credit Union has implemented the following liquidity metrics.

   1. The Credit Union's key liquidity metric is the Liquidity Coverage Ratio ("LCR"). The LCR is a measure that aims to ensure that the credit union has an adequate stock of unencumbered high-quality liquid assets ("HQLA") that can be converted into cash at little or no loss of

value, to meet its liquidity needs for a 30-calendar day liquidity stress scenario.

2. The Net Stable Funding Ratio ("NSFR") is a standard that will require the credit union to maintain a stable funding profile in relation to the composition of their assets and off-balance sheet activities.

3. The Net Cumulative Cash Flow ("NCCF") is a liquidity metric that identifies potential future funding mismatches between contractual inflows and outflows for various time bands over and up to a 12-month time horizon. It measures the credit union's detailed cash flows to capture the risk posed by funding mismatches between assets and liabilities.

4. Another important metric developed by the Credit Union to measure liquidity daily is a measurement known as the Internal Liquidity Ratio ("ILR"). The ILR is measured as a total of unencumbered liquid assets divided by total deposits and borrowings.

The Board has established minimum ratios of 125.0% for the LCR, 110.0% for the NSFR, 100.0% for the NCCF, and 10.0% for the ILR. LCR, NSFR, NCCF and ILR ratios are monitored and reported to MRALCO and the Board Risk Committee/Board quarterly.

At December 31, 2018, DUCA was compliant with these requirements.

3. Market Risk

Market risk is the risk of loss resulting from changes in financial market factors, most commonly through interest rate changes. Interest rate risk is the sensitivity of DUCA's financial position to movements in interest rates. It arises from the fact that assets, liabilities and off-balance sheet instruments mature or re-price at various dates. As interest rates change, net interest income can be negatively impacted based on the distribution of these maturity and re-pricing dates. We assess our level of interest rate risk using an income simulation model. Through this model, we run various scenarios based upon expected interest rate levels and we manage our risk tolerance levels based upon a 1.0% shock to those rates. The process and procedures surrounding this are governed by a defined policy, which is approved by the Board.

At December 31, 2018, DUCA was compliant with these requirements.

Strategic Risk

Strategic risk is the risk that DUCA is unable to identify and adapt to changes in the business environment and/or is unable to implement appropriate business plans and strategies.

DUCA manages its strategic risk through its strategic planning process. The ELT, led by the CEO is responsible for developing and recommending strategies and operational plans, which address key industry, competitive, and consumer trends as well as the Credit Union's key areas of strength and limitation. Strategies and plans are developed by the ELT to align with the overarching strategic direction set by the Board. To set direction and review progress, the Board provides input to, approves, and reviews annual strategic and operational plans, and evaluates performance toward goals and objectives.

Compliance Risk

Compliance risk is exposure to legal penalties, financial forfeiture and material loss DUCA could incur when it fails to act in accordance with industry laws and regulations or internal policies.

In many cases, compliance risk results from inadequate controls or issues related to training, due diligence and human error. Compliance capabilities, processes, practices and training can be a significant challenge and cost.

While the ELT is responsible for ensuring compliance on issues related to products and services, transactions, sales and service practices and new and existing business activities, all DUCA employees are responsible for protecting DUCA's reputation and ensuring compliance with applicable laws, regulations, and standards.