Do more. Be more. Achieve more.

2022 Management's Discussion & Analysis

Management’s Discussion & Analysis

This Management’s 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, 2022, as compared to December 31, 2021. 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”). 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.

Outlook

Global economic uncertainty remains elevated due to the economic impacts of rising interest rates, declining house prices, inflationary pressures, labour market shortages and geopolitical risks arising from the current conflict between Russia and Ukraine. The effect of fiscal and monetary stimulus arising from the COVID-19 pandemic and subsequent monetary policy tightening including an increase of 425 basis points increase in Bank of Canada overnight rate in the period from March 2, 2022 to January 25, 2023 is reflected in a steeply inverted bond yield curve and some expectation of recession and housing market correction over the next 12 months. The Bank of Canada has indicated that if economic developments stay in line with its current projections, it expects to hold its key interest rate at its current level but is prepared to increase the policy rate further if needed to return inflation to the 2% target.

The rapidly rising interest environment, together with a steeply inverted yield curve, resulted in increases in interest rates on short-term deposits which significantly outpaced increases in interest rates earned on longer-term mortgage assets during 2022. The resulting reduction in net interest spread is expected to persist into 2023. Global financial sector instability emerging in March 2023, led by the failures of U.S. local banks, while having no material contagion impact discernable in Canada, has added to unprecedented levels of volatility in Canadian market interest rates. Concerns for borrower affordability amidst a rising interest rate environment with falling housing prices also somewhat increases inherent risks of credit losses.

The Credit Union will build on its business strengths and position itself for profitable, moderated growth within the framework of a sustainable risk culture. As part of its regular review of market conditions, management assesses and manages the balance between net interest spread and portfolio growth and business mix. Loan originations and growth are expected to moderate in 2023. Management is also focused on cost efficiency and effectiveness to optimize income and focused on greater diversification in funding sources to manage the cost of funds and expand funding flexibility.

Beyond the next 12 months as capital markets and the market bond yield curve normalize, the Credit Union expects to experience a recovery in net interest spread and income as the overall trend has been an increase in loan asset yields in comparison to prior years. Management will continue to diversify business growth, strengthen capital, invest in our people, process, technology, risk management and compliance framework aligned with our strategic roadmap, vision and mission of providing financial care and sharing profits, helping people, businesses and communities do more, be more and achieve more.

Financial Results Highlights

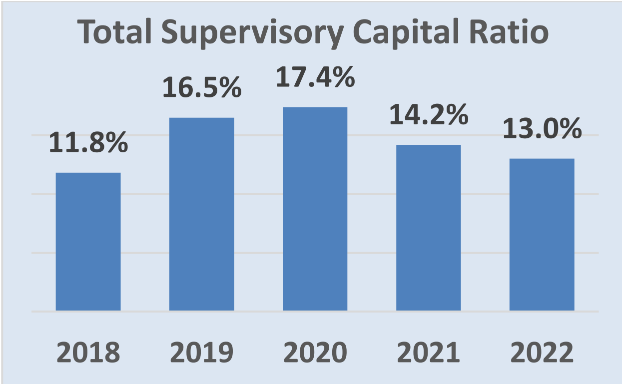
- Net income for the year ended December 31, 2022 was $16.3 million compared to $25.7 million for the year ended December 31, 2021.
- Income before patronage and tax for the year ended December 31, 2022 was $20.0 million compared to $31.7 million for the year ended December 31, 2021.
- On April 1, 2022, the Credit Union acquired 100% of outstanding common shares of Continental Currency Exchange Canada Ltd. [“CCE”], a foreign currency exchange and money transfer business. The results of CCE were consolidated from the acquisition date and include revenue of $11.7 million and after-tax profit of $1.0 million.
- Interest income of $218.1 million for the year ended December 31, 2022 was up by $48.9 million, or 28.9%, year over year driven by loan growth and higher asset yield. Interest expense of $141.1 million for the year ended December 31, 2022 was up by $56.3 million, or 66.3%, year over year driven by deposit growth and higher funding costs. Net interest income of $76.9 million for the year ended December 31, 2022 was down by $7.3 million, or 8.7%, year over year, as growth in funding costs outpaced growth in asset yield driven by rapid pace of rise in the bench mark interest rate and high inflation resulting in an inverted interest rate yield curve.
- Other income of $28.1 million for the year ended December 31, 2022 was up by $13.7 million or 95.3%, year over year driven primarily by the addition of revenue from CCE.
- The recovery of credit losses for the year ended December 31, 2022 was $927 thousand compared to a provision for credit losses of $37 thousand for the year ended December 31, 2021. This was primarily driven by release of remaining provision related to the pandemic as well as release of provision related to one large commercial loan, partially offset by higher balances reflecting portfolio growth.
- Non-interest expense of $86.0 million was $19.0 million, or 28.3%, higher than the prior year primarily driven by the addition of expenses from CCE, volume related direct costs and investments made by the Credit Union to support planned growth.
- Other comprehensive loss was $1.0 million in 2022 [2021 – nil] reflecting net loss on derivatives designated as cash flow hedges that is yet to be reclassified to net income. Derivatives designated as cash flow hedges during 2022 were used to hedge interest rate risk exposure related to the Credit Union’s assets and liabilities.
- Total assets were $6.94 billion at December 31, 2022 compared with $5.52 billion at the end of 2021 and up 25.6% year over year driven primarily by Member loan growth.
- Assets under administration, which include off-balance sheet wealth management assets, were $7.44 billion compared with $6.03 billion in 2021, up 23.4% year over year.
- Member loans increased to $6.41 billion, up 32.2% from $4.85 billion at the end of 2021.
- Goodwill increased to $10.1 million, up from $1.7 million at the end of 2021 reflecting goodwill from the acquisition of CCE.
- Member deposits increased to $5.60 billion, up 22.9% from $4.55 billion at the end of 2021.
- Securitization liabilities decreased to $435.6 million, down 7.0% from $468.2 million at the end of

[1] Subsequent to year-end, on March 1, 2023, the Board of Directors declared a dividend of 3.53% on the outstanding amount of the Class B Series 1 investment shares, and a dividend of 4.25% on the outstanding amount of the Class B Series 4 investment shares. to the holders of record as at December 31, 2022. The dividends were subsequently paid in April 2023.

2021 attributable to lower volumes of insurable loans eligible for securitization.

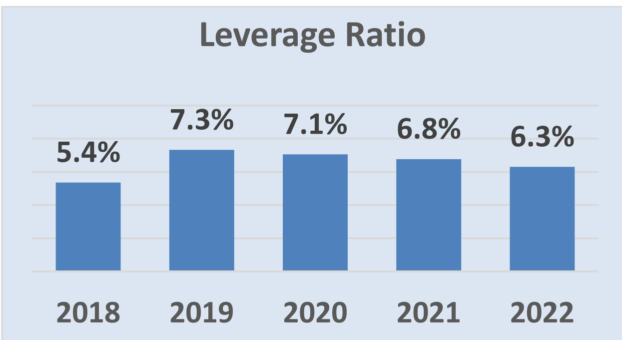
- The Credit Union issued subordinated debt in 2022 in the principal amount of $75 million, maturing on March 29, 2032 with earliest par redemption date of March 29, 2027 [2021 – nil].
- In 2022, DUCA returned to its Members $0.8 million and $0.7 million in the form of profit-sharing Class A patronage and dividends, respectively. Cumulatively, since 1999, DUCA has returned over $81.8 million to its Members in profit-sharing Class A patronage and dividends.[1]
- DUCA paid $1.1 million in dividends to holders of Class B Series 1 investment shares in 2022, and $7.4 million cumulatively since 2017.[1]
- DUCA paid $6.9 million in dividends to holders of Class B Series 4 investment shares in 2022, and $14.2 million cumulatively since 2021.[1]
- Return on average equity ("ROE") was 4.4% for the year ended December 31, 2022 compared to 7.4% for the year ended December 31, 2021 driven by lower earnings.
- The leverage ratio was 6.3% at December 31, 2022 compared with 6.8% at the end of 2021. The regulatory minimum requirements at December 31, 2022 and 2021 were 3% and 4.0%, respectively.
- The supervisory capital ratio was 13.0% at December 31, 2022 compared with 14.2% at December 31, 2021. The regulatory minimum requirements as of December 31, 2022 and 2021 were 10.5% and 8.0%, respectively.

[1] Subsequent to year-end, on March 1, 2023, the Board of Directors declared a dividend of 3.53% on the outstanding amount of the Class B Series 1 investment shares, and a dividend of 4.25% on the outstanding amount of the Class B Series 4 investment shares. to the holders of record as at December 31, 2022. The dividends were subsequently paid in April 2023.



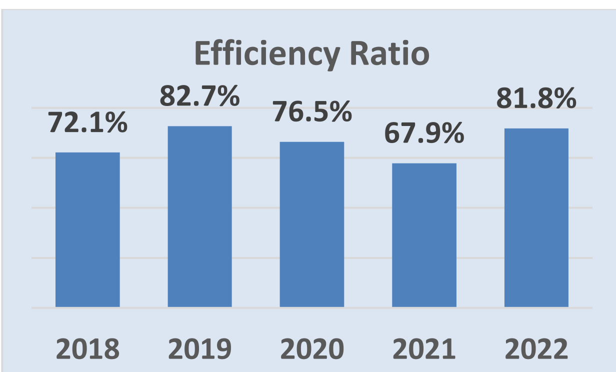
The **Supervisory Capital Ratio** is the ratio of regulatory capital divided by risk-weighted assets ("RWA"). RWA is the sum of the absolute value of assets including defined off-balance sheet exposures in specified categories multiplied by a corresponding percent, varying between 0% and 100% depending on the risk attributed to each category.

In 2022, The Financial Services Regulatory Authority of Ontario ("FSRA") changed the minimum total supervisory capital ratio from 8.0% to 10.5%. At December 31, 2022, the total supervisory capital ratio was 13.0% compared with 14.2% in 2021.



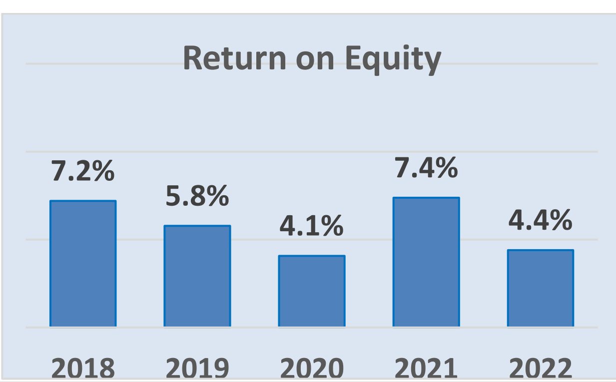
The **Leverage Ratio** is the ratio of regulatory capital divided by the sum of total assets and defined off-balance sheet exposures.

In 2022, FSRA changed the minimum required leverage ratio 4.0% to 3.0%. The leverage ratio was 6.3% at December 31, 2022 compared with 6.8% in 2021.



The **Efficiency Ratio** (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 Efficiency Ratio was 81.8% for the year ended December 31, 2022, up from 67.9% in the prior year. The increase in ratio is driven by lower revenue and higher non-interest expense in 2022.



ROE is calculated as net income before patronage as a percentage of average Members' equity.

DUCA's ROE was 4.4% during 2022 compared to 7.4% in 2021. The lower ratio is driven by lower earnings in 2022.

2022 Financial Performance Review

Net Interest Income

Net interest income is composed of earnings on assets, such as loans and securities, less interest expense paid on liabilities, such as deposits and securitizations.

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

($ millions)	2022				2021			
	Average Balance	Interest	Mix	Rate	Average Balance	Interest	Mix	Rate
Cash equivalents and investments	481.9	14.5	7.6%	3.0%	680.8	11.0	13.1%	1.6%
Personal loans	112.6	5.4	1.8%	4.8%	53.1	1.7	1.0%	3.1%
Residential mortgages	4,320.1	131.4	68.0%	3.0%	3,315.9	103.6	63.7%	3.1%
Commercial loans	1,283.2	66.9	20.2%	5.2%	1,066.6	52.8	20.5%	4.9%
Other	152.8	-	2.4%		86.9	-	1.7%	
Total assets	6,350.5	218.1	100.0%	3.4%	5,203.3	169.1	100.0%	3.3%
Deposits	5,204.9	114.6	82.0%	2.2%	4,219.2	70.3	81.1%	1.7%
Borrowings & securitization	661.3	23.0	10.4%	3.5%	604.0	14.5	11.6%	2.4%
Subordinated debt	63.2	3.5	1.0%	5.6%				
Other	53.1	-	0.8%		20.3	-	0.4%	
Total liabilities	5,982.4	141.1	94.2%	2.4%	4,843.5	84.8	93.1%	1.8%
Members' equity	368.1	-	5.8%		359.8	-	6.9%	
Total liabilities and Members' equity	6,350.5	141.1	100.0%	2.2%	5,203.3	84.8	100.0%	1.6%
Net interest income		76.9		1.2%		84.3		1.7%

Interest and investment income were $218.1 million for the year ended December 31, 2022 compared with $169.1 million for the year ended December 31, 2021. The increase of $49.0 million, or 29.0%, was driven by loan growth and higher asset yield. Average yields on assets were 3.40% for the year ended December 31, 2022 compared with 3.3% for the prior year reflecting the impact on new and existing loan pricing and re-pricing in connection with the in-year impact from the 400 bps increase in Bank of Canada overnight benchmark interest rate during 2022 .

Interest expense on deposits was $114.6 million for the year ended December 31, 2022 compared with $70.3 million for the prior year. The average rate of expense on deposits increased to 2.4% compared with 1.8% for the prior year. This trend reflects higher deposit volume, contributing to the funding of loan growth combined with a higher average interest rate for deposit funds. The increase in average deposit interest rates reflects the rapid increase in the Bank of Canada overnight benchmark interest rate during 2022. This rapid increase, aimed at tempering inflation, led to an inverted interest rate yield curve (wherein rates at the short end of the yield curve are higher than rates at the long end). In such an environment, depositors prefer to place savings in shorter-term deposits carrying higher interest rates than longer-term savings.

Borrowing and securitization costs were $26.5 million, up $12.0 million, or 82.3%, due to the addition of interest expense on subordinated debt issued in 2022 and higher cost of funds on borrowings.

The overall net interest spread was 1.2% for the year ended December 31, 2022 compared with 1.7% for the year ended December 31, 2021. Growth in cost of funds outpaced growth in asset yields in 2022 contributed to decline in spread.

Non-Interest Income

($ millions)	2022			2021		
	Income	Mix	% of average assets	Income	Mix	% of average assets
Foreign exchange fee revenue	11.6	41.3%	0.2%	0.4	2.7%	0.0%
Securitization income	4.2	14.9%	0.1%	4.4	30.8%	0.1%
Wealth management	3.4	12.1%	0.1%	3.0	20.9%	0.1%
Realized gains on derivative financial instruments	3.4	12.1%	0.1%	-	0.0%	0.0%
Mortgage and loan fees	3.2	11.4%	0.1%	1.5	10.8%	0.0%
Service charges	1.3	4.6%	0.0%	1.5	10.3%	0.0%
Unrealized gains on derivative financial instruments	0.5	1.8%	0.0%	-	0.0%	0.0%
Gain on sale of property and equipment	0.0	0.0%	0.0%	2.1	14.4%	0.0%
Gain on sale of Social Finance Inc. ["SoFi"] shares	0.0	0.0%	0.0%	0.7	4.6%	0.0%
Other	0.5	1.8%	0.0%	0.8	5.6%	0.0%
Total	28.1	100.0%	0.4%	14.4	100.0%	0.3%

Non-interest income, which comprises all revenues other than net interest income, increased by $13.7 million, or 95.3%, to $28.1 million in 2022. The year-over-year increase is primarily due to the inclusion of CCE's foreign exchange fee revenue starting on April 1, 2022, realized gains or derivative financial instruments, partially offset by gain on sale of DUCA's Rexdale branch in 2021 that did not reoccur in 2022.

The Credit Union securitizes and sells mortgage-backed securities of certain insured Multi-Unit Residential Building ("MURB") mortgages with no or little prepayment or credit risk associated with the sold mortgage-backed securities. The outstanding balance for these MURB mortgages were $1.88 billion at December 31, 2022 (2021 – $1.12 billion).

The Credit Union enters into certain transactions that allow the transfer of the contractual right to receive the residual cash flows from the mortgages and transfer substantially all of the risks and rewards of ownership, including credit, interest rate, prepayment and other price risks. The present value of the future cash flows is recorded on the statement of financial position under other assets.

Provision for Credit Losses

The following table presents the carrying amount of loans by portfolio and the balance of their respective ECL allowance as at December 31, 2022 (in thousands of Canadian dollars):

	Stage 1	Stage 2	Stage 3	Total

	Gross carrying amount $	ECL allowance $	Gross carrying amount $	ECL allowance $	Gross carrying amount $	ECL allowance $	Gross carrying amount $	ECL allowance $
Residential mortgages	4,706,866	1,193	143,184	372	12,678	318	4,862,728	1,883
Commercial loans	1,309,352	2,153	54,130	1,218	23,342	169	1,386,824	3,540
Personal loans	123,657	273	4,383	88	9	5	128,049	366
Total	6,139,875	3,619	201,697	1,678	36,029	492	6,377,601	5,789

The following table presents the carrying amount of loans by portfolio and the balance of their respective ECL allowance as at December 31, 2021 (in thousands of Canadian dollars):

	Stage 1		**Stage 2**		**Stage 3**		**Total**	
	Gross carrying amount $	**ECL allowance $**	**Gross carrying amount $**	**ECL allowance $**	**Gross carrying amount $**	**ECL allowance $**	**Gross carrying amount $**	**ECL allowance $**
Residential mortgages	3,549,236	409	63,585	108	4,942	96	3,617,763	613
Commercial loans	1,018,465	2,361	91,671	2,673	20,957	898	1,131,093	5,932
Personal loans	79,341	193	752	42	6	3	80,099	238
Total	4,647,042	2,963	156,008	2,823	25,905	997	4,828,955	6,783

As at December 31, 2022, the Credit Union's ECL allowance for Members' loans was $5.8 million (2021 – $6.8 million). The related recovery of credit losses was $974 thousand for the year ended December 31, 2022 (2021 – PCL of $75 thousand), driven by release of remaining provision related to the pandemic as well as release of provision related to one large commercial loan, partially offset by higher balances reflecting portfolio growth. The Credit Union's investment in third-party mortgages and mortgage pools was presented net of ECL allowances of $0.1 million (2021 – $0.1 million) and the related provision of credit losses was $47 thousand for the year ended December 31, 2021 (2021 – recovery of credit losses of $37 thousand).

The Credit Union uses a 10-point risk rating model to measure and manage its exposure on its commercial loan portfolio. This risk rating model aligns with equivalent public debt ratings published by rating agencies. The 10-point rating scale ranges from Substantially Risk Free (1) to Unacceptable/Impaired Risk (10). A risk rating in the range of 1 to 6 is deemed to be acceptable risk for new loans.

The Credit Union uses the borrower's credit score as one benchmark to manage the risk of the retail portfolio. A credit score is one measure on how likely a person is to repay a loan. DUCA's risk ratings range across four bands: very low risk, low risk, moderate risk and high risk. While DUCA generally originates retail loans with very low to moderate risk, DUCA has lending programs that assist Members who are in need of credit, addressing the borrower's credit score factor. These loans are priced accordingly based on risk profile.

The following table sets out the Credit Union's credit risk exposure for all Members' loans carried at amortized cost as at December 31, 2022. Stage 1 represents those performing loans carried with a 12-

month ECL, Stage 2 represents those performing loans carried with a lifetime ECL, and Stage 3 represents those loans with a lifetime ECL that are credit impaired.

The internal risk ratings are defined as follows:

Very low risk: Loans that generally have substantially below average probability of credit default, which is within the Credit Union's risk appetite levels.

Low risk: Loans that generally have below average probability of credit default, which is within the Credit Union's risk appetite levels.

Medium risk: Loans that generally have an average probability of credit default, which is within the Credit Union's risk appetite levels.

High risk: Loans that were originated within the Credit Union's risk appetite but have subsequently experienced an increase in risk of credit default, which is outside of the Credit Union's typical risk tolerance levels. The Credit Union will generally not originate loans in this category. DUCA has retail lending programs that assist Members who are in need of credit, notwithstanding the borrower's credit score. These loans are priced accordingly based on risk profile.

(In thousands of Canadian dollars)	**Stage 1** $	**Stage 2** $	**Stage 3** $	**Total** $
Residential				
Very low risk	2,473,153	—	—	2,473,153
Low risk	1,853,846	—	—	1,853,846
Moderate risk	373,206	114,633	—	487,839
High risk	6,661	28,551	12,678	47,890
	4,706,866	143,184	12,678	4,862,728
Commercial				
Low risk	230,573	—	—	230,573
Moderate risk	1,078,779	—	—	1,078,779
High risk	—	54,130	23,342	77,472
	1,309,352	54,130	23,342	1,386,824
Personal				
Very low risk	103,465	—	—	103,465
Low risk	19,646	—	—	19,646
Moderate risk	540	4,316	—	4,856
High risk	6	67	9	82
	123,657	4,383	9	128,049
	6,139,875	201,697	36,029	6,377,601

The following table sets out the Credit Union's credit risk exposure for all Members' loans carried at amortized cost as at December 31, 2021. Stage 1 represents those performing loans carried with a 12-month ECL, Stage 2 represents those performing loans carried with a lifetime ECL, and Stage 3 represents those loans with a lifetime ECL that are credit impaired.

(In thousands of Canadian dollars)	Stage 1 $	Stage 2 $	Stage 3 $	Total $
Residential				
Very low risk	1,883,743	—	—	1,883,743
Low risk	1,323,193	—	—	1,323,193
Moderate risk	331,216	48,354	—	379,570
High risk	11,084	15,231	4,942	31,257
	3,549,236	63,585	4,942	3,617,763
Commercial				
Low risk	183,208	—	—	183,208
Moderate risk	835,257	—	—	835,257
High risk	—	91,671	20,957	112,628
	1,018,465	91,671	20,957	1,131,093
Personal				
Very low risk	67,811	—	—	67,811
Low risk	10,833	—	—	10,833
Moderate risk	685	690	—	1,375
High risk	12	62	6	80
	79,341	752	6	80,099
	4,647,042	156,008	25,905	4,828,955

As at December 31, 2022, 94% of outstanding commercial loans are risk rated in acceptable range of 6 or less (2021 – 90%) based on the Credit Union's model.

Total loans in arrears greater than 30 days increased to $44.4 million at the end of 2022 compared with $40.2 million at December 31, 2021 however as a percentage of total Members' loans, the ratio declined to 0.7% at the end of 2022 compared to 0.8% a year ago.

In the past year, while many COVID-19 pandemic-related risks are receding and measures to contain the spread of the virus have lifted in many regions, the pandemic has contributed to secondary macroeconomic outcomes arising from Government and Central Bank actions that impact Canada, the U.S., and global economies including factors influencing high levels of inflation, rising interest rates, and the resulting threat of recession and housing market correction. While these changing assumptions may result in current forward-looking scenarios that are different from those used by the Credit Union in its ECL measurement as at December 31, 2022, based on the information available at the end of the year, IFRS 9 does not permit the use of hindsight in measuring ECL. Accordingly, any changes in forward-looking information subsequent to December 31, 2022 will be reflected in the measurement of ECL in future periods as appropriate.

Note 9 to the financial statements has additional disclosures with respect to ECL and its movements, gross loans by security type, key macroeconomic inputs used in scenarios, and delinquency aging analysis.

Non-Interest Expense

($ millions)	2022			2021		
	Expense	Mix	% of average assets	Expense	Mix	% of average assets
Salaries and benefits	46.9	54.5%	0.7%	37.4	55.8%	0.7%
Occupancy	4.7	5.5%	0.1%	3.0	4.5%	0.1%
Technology	6.1	7.1%	0.1%	5.6	8.3%	0.1%
Other general and administrative expenses	28.3	32.9%	0.4%	21.0	31.4%	0.4%
Total	86.0	100.0%	1.4%	67.0	100.0%	1.3%

Total non-interest expenses in 2022 were $86.0 million, up $19.0 million, or 28.3%, from the prior year driven by volume-related direct costs, addition of $10.5 million of CCE expenses since acquisition on April 1, 2022, and continued investments in people, systems and processes made by the Credit Union to support planned growth. Non-interest expenses in 2021 was exceptionally low due to the impact of COVID-19 related closures and restrictions.

The Efficiency Ratio was 81.8% compared with 67.9% for the years ended December 31, 2022 and 2021, respectively, driven by lower revenue and higher non-interest expense in 2022.

Financial Condition Review

Total assets were $6.94 billion at December 31, 2022 compared with $5.52 billion at the end of 2021 and up 25.6% year-over-year due to an increase in loan balances.

DUCA's Member loan growth during 2022 was $1.56 billion, resulting in an increase in loan balances of 32.3% from 2021's loan balances of $4.85 billion.

Residential mortgage balances increased by $1.24 billion, or 34.4% (2021 – $512.6 million, or 16.5%). Loan growth was evenly distributed from all of DUCA's channels including proprietary channels which include Branches, Mobile Mortgage Specialists and Member Connect call centre, as well as from broker and partnership channels.

DUCA's commercial loan balances increased by $255.7 million, or 22.6%, with all growth being supported by strong real estate assets within DUCA's geographic footprint.

Cash and cash equivalents, and investments and third-party mortgages totaled $378.9 million at December 31, 2022, down from $602.4 million in 2021. This decrease was primarily due to lower levels of cash and cash equivalents held at December 31, 2022 and reflected the return to more normalized level of liquidity.

Member deposits increased to $5.60 billion at December 31, 2022, up $1.04 billion, or 22.9%, from 2021 to fund asset growth.

DUCA continued its program of securitizing residential mortgages through Canada Mortgage and Housing Corporation (“CMHC”) NHA MBS, Canada Mortgage Bond (“CMB”) Programs and Canadian bank-sponsored asset-backed commercial paper (ABCP) programs in 2022. 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.

Securitization liabilities decreased to $435.6 million, down $32.6 million, or 7.0%, from the prior year as a result of lower levels of insurable mortgages originated by the Credit Union eligible for securitization pooling, partially offset by higher securitization liability from bank-sponsored asset-backed commercial paper programs.

A comprehensive credit facility is maintained with Bank of Montreal up to a maximum of $14.0 million (2021 – $14.0 million) and is secured by bank deposit notes totaling $10.0 million (2021 – $10.0 million). The Credit Union has an unused credit facility of $14.0 million (2021 – $14.0 million) at year-end.

A line of credit is maintained with Central 1 up to a maximum of $256.4 million (2021 – $235.0 million) and is secured by a general security agreement covering all the assets of the Credit Union. The Credit Union has an unused credit facility of $144.5 million (2021 – $134.2 million) as at year-end, of which $85.0 million (2021 – $100.0 million) is prescribed for the guarantee of payment on third-party municipalities, universities, school boards and hospitals deposits with the Credit Union as agreed to by Central 1 and $25.0 million (2021 – $30.0 million) is prescribed towards letters of credit issued on behalf of the Credit Union.

A line of credit facility is maintained with Desjardins up to a maximum of $250.0 million (2021 – $175.0 million) and is secured by a pledge of residential mortgages. The Credit Union has an unused credit facility of nil (2021 – $175.0 million) as at year-end.

A Bond Market Association/International Securities Market Association 2000 Version Global Master Repurchase Agreement is maintained with National Bank Financial Inc., which gives the Credit Union access to an uncommitted $350.0 million (2021 – $350.0 million) credit facility where the Credit Union can access borrowing on a short-term basis by pledging mortgage-backed securities that they are holding for liquidity. At December 31, 2022, the Credit Union has an unused credit facility of $350.0 million (2021 – $350.0 million).

A Bond Market Association/International Securities Market Association 2000 Version Global Master Repurchase Agreement is maintained with Bank of Montreal, which gives the Credit Union access to an uncommitted $400.0 million (2021 – $400.0 million) credit facility where the Credit Union can access borrowing on a short-term basis by pledging mortgage-backed securities that they are holding for liquidity. At December 31, 2022, the Credit Union has an unused credit facility of $368.7 million (2021 – $400.0 million).

A Bond Market Association/International Securities Market Association 2000 Version Global Master

Repurchase Agreement is maintained with Central 1, which gives the Credit Union access to an uncommitted credit facility where the Credit Union can access borrowing on a short-term basis by pledging mortgage-backed securities that they are holding for liquidity.

Regulatory capital was $443.1 million at December 31, 2022 up from $373.5 million at December 31, 2021 driven by the issuance of subordinated debt of $75.0 million during 2022 [2021 – nil] which increased Tier II capital and higher retained earnings, partially offset by higher goodwill from the CCE acquisition and contractually permitted annual Class A and B share redemptions.

Wealth assets under management was $502.9 million at December 31, 2022 slightly down from $505.0 million at December 31, 2021. Wealth net sales was more than offset by market value decline in 2022 due to volatile market conditions partly impacted by rapidly increasing interest rate and highly uncertain economic environment. Wealth assets include mutual funds, stocks and bonds offered through an arrangement with Aviso Wealth at December 31, 2022.

Subsequent to December 31, 2022, the Credit Union received and processed redemption requests for Class B Series 1 investment shares amounting to $3,265.

Dividends

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

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

($ millions)	2022	2021	2020	2019	2018
Profit-sharing patronage return	0.8	1.5	2.2	1.4	1.2
Class A profit-sharing shares dividend	0.7	0.7	0.7	0.8	0.8
Class B series 1 shares dividend	1.1	1.2	1.4	1.2	1.2
Class B series 4 shares dividend	6.9	7.3	-	-	-

On March 1, 2022, the Board of Directors declared a dividend of 3.0% on the outstanding amount of the Class B Series 1 investment shares, a dividend of 4.25% on the outstanding amount of the Class B Series 4 investment shares, and a dividend of 2.0% on the outstanding amount of Class A shares to the holders of record as at December 31, 2021. The dividends were paid on March 2, 2022. During 2022, the Board of Directors declared a profit-sharing patronage return of 0% (2021 – 1.0%) consisting of bonus interest on Members' deposits and loans. Profit-sharing patronage will be replaced by the Do More Profit Sharing Program launching in April 2023.

Subsequent to year-end, on March 1, 2023, the Board of Directors declared a dividend of 3.53% on the outstanding amount of the Class B Series 1 investment shares, and a dividend of 4.25% on the outstanding amount of the Class B Series 4 investment shares to the holders of record as at December 31, 2022. The dividends were subsequently paid in April 2023.

Capital Management

DUCA actively manages capital to maintain robust capital ratios and provide returns to our members, through an optimal capital structure and disciplined balance sheet management that provides flexibility for organic growth and strategic acquisitions. The Credit Union's objectives with respect to capital management are to strengthen and maintain a capital base that is structured to exceed regulatory requirements and to best utilize capital allocations.

DUCA's capital management framework sets the overall governance approach, including guiding principles, roles and responsibilities, and establishes policies and processes for maintaining appropriate and prudent levels of capital. DUCA's capital oversight 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. The Board regularly reviews DUCA's capital position and key capital management activities.

On March 1, 2022, the Credit Unions and Caisses Populaires Act, 2020 ("CUCPA 2020" or "New Act") came into force, replacing the Credit Unions and Caisses Populaires Act, 1994 ("CUCPA 1994"). Along with the New Act, three new Credit Union Rules developed by FSRA, Sound Business and Financial Practices Rule, Capital Adequacy Requirements Rule, and Liquidity Adequacy Requirements Rules also came into force on March 1, 2022.

The Capital Adequacy Requirements Rule in particular outlined significant changes to capital requirements including i) definition and calculation of capital and risk weighted assets, ii) revision in supervisory minimum ratios, iii) introduction of a capital conservation buffer and iv) capital reporting of subsidiaries on a consolidated basis, among other changes.

Upon adoption of the Capital Adequacy Requirements Rule outlined in the New Act, the Credit Union reclassed non-redeemable class A shares from tier 2 to tier 1 capital, which amounted to $34,110 as at December 31, 2022.

Capital Requirements

The Credit Union considers its capital to include Membership shares, Class A shares and Class B investment shares, retained earnings and subordinated debt. Total regulatory capital at December 31, 2022 was $443.1 million [2021 - $373.5 million].

The Credit Union establishes the risk-weighted equivalent value of its assets in accordance with the regulations of the Act, which establishes the applicable percentage for each class of assets. The Credit Union's risk-weighted equivalent value of its assets as at December 31, 2022 was $3,407,020 [2021 – $2,633,928].

At December 31, 2022, the Credit Union met the capital requirements of the Act.

	2022			2021		
	Actual %	Regulatory policy minimum %	Internal policy minimum %	Actual %	Regulatory policy minimum %	Internal policy minimum %
Leverage ratio	**6.34**	**3.00**	**4.00**	6.77	4.00	5.00
Retained earnings to risk-weighted asset ratio	**4.23**	**3.00**	**3.25**	N/A	N/A	N/A
Tier 1 capital ratio	**10.62**	**6.50**	**7.00**	12.57	N/A	N/A
Capital conservation buffer ratio	**4.12**	**2.50**	**2.50**	N/A	N/A	N/A
Total supervisory capital ratio	**13.01**	**10.50**	**11.00**	14.18	8.00	10.50

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 DUCA's Enterprise Risk Management Policy are Risk Appetite Statements ("RAS") and the 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 Enterprise Risk Management Policy, ERMF, and related policies reflect 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 is 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 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 uses 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, including Compliance and anti-money laundering and anti-terrorist financing functions. The Management Risk and Asset Liability Committee ("MRALCO") and the Management Compliance and Operational Risk Committee ("MCORC") oversees enterprise-wide risk taking and risk mitigation activities.

- 3rd Line of Defense - The third line of defense consists of internal and external audit functions, 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 and MCORC.

Our ERMF defines and categorizes risks 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 and adjudication authority structure for the approval, amendment, and renewal of credit facilities;
- Delegating authorization limits to the Board Credit Committee, 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 Members and counterparties;
- Compliance with agreed exposure limits. Monthly reports are provided to the MCC and to the Board on the quality of the loan portfolio.

The CRMP applies to all loan products and includes personal, residential mortgage, small business, wealth management, and commercial lending.

Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people, systems, and external events. DUCA is exposed to a broad range of operational risks including talent acquisition, retention, performance and succession, technology and systems failures, fraud, theft and misappropriation of assets, business disruption, information, privacy, and 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. The Credit Union has a number of programs that manage specific risks under the operational risk framework, including business resilience planning, disaster recovery planning, anti-money laundering and anti-terrorist financing procedures, employee hiring and retention measures and vendor and third-party relationship risk management.

Capital, Liquidity and Market Risk

1. Capital Risk

   The Internal Capital Adequacy Assessment Process ("ICAAP") is an integrated enterprise-wide process for evaluating and determining the amount of capital required to manage through unexpected losses arising from adverse economic and operational conditions. The methodology used to calculate the internal capital requirements incorporates all the material risks faced by DUCA and is reflective of the actual risk profile.

   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 FSRA annually. During 2022, the application of the ICAAP confirmed that DUCA's capital levels were sufficient. The Credit Union expects continued 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 refers to the risk of having insufficient cash or collateral to meet financial obligations in a timely manner, and an inefficacy to raise funding or monetize assets at non-distressed prices. Liquidity risk arises from mismatches in the timing and value of on-balance sheet and off-balance sheet cash flows, and depends on diversity in funding sources, the business mix, balance sheet structure, and contingent liquidity events that require additional funding for undrawn loan commitments or deposit attrition.

   The Credit Union's liquidity management framework is designed to ensure that adequate sources of reliable and cost-effective cash or its equivalents are continually available to satisfy its current and prospective financial commitments under normal and contemplated stress conditions.

   Provisions of the Act require the Credit Union to maintain a prudent amount of liquid assets in order to meet Member withdrawals, which includes the Liquidity Coverage Ratio ("LCR"), Net Cumulative

Cash Flow (“NCCF”), and Net Stable Funding Ratio (“NSFR”).
The Credit Union manages liquidity risk by:

- Continuously monitoring actual daily cash flows and longer-term forecasted cash flows;
- Monitoring the maturity profiles of financial assets and liabilities; and
- Maintaining adequate reserves, liquidity support facilities and reserve borrowing facilities.

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. At a minimum, the stock of unencumbered HQLA should enable the institution to survive until day 30 of the stress scenario, by which time it is assumed that appropriate corrective actions can be taken by management. DUCA’s LCR at December 31, 2022 was 655% (2021 – 618%) compared with a regulatory minimum of 100% and a policy minimum of 125%.

The NCCF is a liquidity metric that measures the Credit Union’s survival horizon based on its net cumulative cash flows. It identifies potential future funding mismatches between contractual inflows and outflows for various time bands over and up to a 12-month time horizon. DUCA’s NCCF as at December 31, 2022 was coverage over 11 months compared with a policy minimum of coverage over 6 months.

The NSFR is a standard that will require credit unions to maintain a stable funding profile in relation to the composition of their assets and off-balance sheet activities. A sustainable funding structure is intended to reduce the likelihood that disruptions to a credit union’s regular sources of funding will erode its liquidity position in a way that would increase the risk of its failure and potentially lead to broader systemic stress. The NSFR aims to limit over-reliance on short-term wholesale funding, encourages better assessment of funding risk across all on- and off-balance sheet items, and promotes funding stability. DUCA’s NSFR as at December 31, 2022 was 156% (2021 – 171%) compared with a regulatory minimum of 100% and a policy minimum of 110%.

3. Market Risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate as a result of market factors. Market factors include three types of risk: interest rate risk, currency risk and equity risk.

[i] Interest rate risk
Interest rate risk is the potential for financial loss caused by fluctuations in fair value or future cash flows of financial instruments because of changes in market interest rates. The Credit Union is exposed to this risk through traditional banking activities, such as deposit taking and lending and on its investments.

The Credit Union’s goal is to manage the interest rate risk of the statement of financial position to a target level. The Credit Union continually monitors the effectiveness of its interest rate mitigation activities.

The Credit Union’s interest rate risk position is measured monthly. Measurement of risk is based on rates charged to Members, as well as rates paid to depositors. Schedules of matching and interest rate vulnerability are regularly prepared and monitored by Credit Union management and reported to FSRA in accordance with the Credit Union’s policy. This policy has been approved by the Board and filed with FSRA by Credit Union regulations. For the year ended December 31, 2022, the Credit Union was in compliance with this policy.

[ii] Currency risk
Currency risk relates to the Credit Union operating in different currencies and converting non-Canadian earnings at different points in time at different foreign exchange levels when adverse changes in foreign currency exchange rates occur.

The Credit Union’s currency risk position is measured daily. Measurement of risk is based on rates charged to clients, as well as currency purchase costs. The Credit Union’s exposure to changes in currency exchange rates is mitigated by limiting the unhedged foreign currency exposure to the lesser of $1.0 million or 5.0% of total Member foreign currency deposits in Canadian funds. For the year ended December 31, 2022, the Credit Union’s exposure to foreign exchange risk is within policy.

[iii] Equity risk
Equity risk is the uncertainty associated with the valuation of assets arising from changes in equity markets. The Credit Union is exposed to this risk through its equity holdings. The total investment in preferred shares and dividend-bearing equities cannot exceed the lesser of $15.0 million or 1% of assets, excluding the Credit Union’s investment in Central 1.

For the year ended December 31, 2022, the Credit Union’s exposure to equity risk is within policy.

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 Executive Leadership Team (“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 the risk of legal or regulatory sanctions, material financial loss, or loss to reputation a credit union may suffer as a result of its failure to comply with laws, regulations, codes of conduct, and standards of practice applicable to its banking activities.

Some of the examples of common compliance risks include crime, corruption, fraud, money laundering, terrorist financing, data protection, privacy breaches, and conflicts of interest.

An effective compliance risk management program is essential for a sound banking system and includes Board oversight of a compliance risk management process. Additionally, senior management sets the organizational tone and priority with the implementation of a compliance culture on an enterprise-wide basis, as well as ensuring the independence of this function. It is the responsibility of all DUCA Employees to protect its reputation and ensure compliance with all applicable laws, regulations, and standards.