Prospera Credit Union

Consolidated Financial Statements
December 31, 2019
(expressed in thousands of dollars)

Independent auditor's report

To the Members of Prospera Credit Union

Our opinion

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of Prospera Credit Union and its subsidiaries (together, the Credit Union) as at December 31, 2019 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

What we have audited
The Credit Union's consolidated financial statements comprise:

- the consolidated statement of financial position as at December 31, 2019;
- the consolidated statement of income and comprehensive income for the year then ended;
- the consolidated statement of changes in members' equity for the year then ended;
- the consolidated statement of cash flows for the year then ended; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies.

Basis for opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence
We are independent of the Credit Union in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada. We have fulfilled our other ethical responsibilities in accordance with these requirements.

PricewaterhouseCoopers LLP
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"PwC" refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership.

Responsibilities of management and those charged with governance for the consolidated financial statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Credit Union's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Credit Union or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Credit Union's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Credit Union's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Credit Union's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Credit Union to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Credit Union to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

PricewaterhouseCoopers LLP

Chartered Professional Accountants

Vancouver, British Columbia
March 16, 2020

Prospera Credit Union

Consolidated Statement of Financial Position

As at December 31, 2019

(expressed in thousands of dollars)

	2019 $	2018 $
Assets		
Cash and cash equivalents	11,251	48,156
Interest bearing deposits	397,532	386,159
Loans (notes 6, 7 and 8)	3,234,569	3,183,760
Investments (note 9)	172,834	159,713
Other assets (note 10)	7,171	7,138
Property, premises and equipment (note 11)	22,033	8,140
Intangibles (note 12)	752	1,044
Retirement benefit asset (note 17)	650	539
Deferred income tax assets (note 23)	2,654	2,567
Derivative financial instruments (note 27)	282	465
Income taxes receivable	408	535
TOTAL ASSETS	3,850,136	3,798,216
Liabilities		
Borrowings (note 13)	576,284	581,505
Lease liabilities (note 14)	15,368	-
Deposits (note 15)	3,102,532	3,060,649
Retirement benefit obligation (note 17)	6,873	7,526
Other liabilities (note 18)	10,004	6,346
Derivative financial instruments (note 27)	1,809	3,778
TOTAL LIABILITIES	3,712,870	3,659,804
Members' Equity		
Capital and reserves attributable to members (note 16)		
Members' equity shares (note 16(c))	-	3,059
Retained earnings	141,872	142,998
Other reserves	(4,606)	(7,645)
TOTAL MEMBERS' EQUITY	137,266	138,412
TOTAL LIABILITIES AND MEMBERS' EQUITY	3,850,136	3,798,216

Commitments and contingent liabilities (notes 18 and 24)

Subsequent events (note 30)

Approved by the Board of Directors

Director

Art Van Pelt, Chair

Director

Rita Virk, Audit Committee Chair

The accompanying notes are an integral part of these consolidated financial statements.

Prospera Credit Union

Consolidated Statement of Income and Comprehensive Income

For the year ended December 31, 2019

(expressed in thousands of dollars)

	2019 $	2018 $
Interest income		
Loans and receivables measured at amortized cost	114,265	102,672
Financial instruments measured at fair value through profit and loss	8,667	11,613
Interest bearing deposits and investments	9,449	8,243
	132,381	122,528
Interest expense		
Deposits	58,311	44,517
Borrowings	10,817	10,958
	69,128	55,475
Net interest income (note 19)	63,253	67,053
Credit impairment losses (note 6)	347	150
Net interest income after provision and impairment charges	62,906	66,903
Other income (note 20)	7,113	(1,171)
Net interest income and other income	70,019	65,732
Non-interest expenses		
Salaries and employee benefits (note 21)	39,512	32,654
Administration	8,229	7,392
Other expenses (note 22)	6,652	6,686
Depreciation and amortization (note 11 and 12)	5,971	2,370
Data processing	3,910	3,525
Occupancy	3,682	7,444
Communication and marketing	1,700	2,103
Clearing charges	1,422	1,547
	71,078	63,721
(Loss) income before dividends on member deposit shares	(1,059)	2,011
Dividends on member deposit shares	73	74
(Loss) income before income taxes	(1,132)	1,937
Recovery of (provision for) income taxes (note 23)		
Current	337	521
Deferred	(399)	(76)
	(62)	445
Net (loss) income for the year	(1,070)	1,492
Other comprehensive income (loss) for the year		
Changes related to defined benefit plans (note 17(e))	354	1,450
Change in fair value of cash flow hedges (note 27)	2,639	1,205
Change in fair value of investments (note 28)	46	(273)
	3,039	2,382
Total comprehensive income	1,969	3,874

The accompanying notes are an integral part of these consolidated financial statements.

Prospera Credit Union

Consolidated Statement of Changes in Members' Equity

For the year ended December 31, 2019

(expressed in thousands of dollars)

			Other reserves			
	Members' equity shares $	Retained earnings $	Defined benefit plans[1] $	Cash flow hedges and retained interest[2] $	Investments[3] $	Members' equity $
Balance – December 31, 2017	3,213	140,218	(6,441)	(3,737)	2,663	135,916
IFRS 9 transition January 1, 2018	-	(1,130)	-	-	-	(1,130)
Net income and other comprehensive income	-	1,492	1,450	1,205	(273)	3,874
Realized gains transferred to retained earnings from other reserves	-	2,512	-	-	(2,512)	-
Dividends on members' equity shares	-	(94)	-	-	-	(94)
Share redemptions	(154)	-	-	-	-	(154)
Balance – December 31, 2018	3,059	142,998	(4,991)	(2,532)	(122)	138,412
Net loss and other comprehensive income	-	(1,070)	354	2,639	46	1,969
Dividends on members' equity shares	-	(56)	-	-	-	(56)
Share redemptions	(3,059)	-	-	-	-	(3,059)
Balance – December 31, 2019	-	141,872	(4,637)	107	(76)	137,266

[1] Changes in other reserves related to defined benefit plans are not recyclable to net income.

[2] Changes in other reserves related to cash flow hedges and retained interest are recyclable to net income.

[3] Changes in other reserves related to investments are not recyclable to net income but will move to retained earnings once realized.

The accompanying notes are an integral part of these consolidated financial statements.

Prospera Credit Union

Consolidated Statement of Cash Flows

For the year ended December 31, 2019

(expressed in thousands of dollars)

	2019 $	2018 $
Cash provided by (used in)		
Operating activities		
Net (loss) income for the year	(1,070)	1,492
Items not affecting cash		
Net interest income (note 19)	(63,253)	(67,053)
Depreciation and amortization (note 11 and 12)	5,971	2,370
Provision for expected credit losses and impairment loss on financial assets	347	150
Provision for current income taxes	337	521
Deferred income taxes	(399)	(76)
Net change in fair value of derivative financial instruments (note 28)	(270)	(241)
Net change in fair value of secured borrowings	-	(2,910)
Net change in fair value of investments	(56)	329
Net loss on loans held at fair value through profit and loss (note 6)	(6,506)	(15,381)
Loss on sale of property, premises and equipment	1	42
	(64,898)	(80,757)
Net change in loans held at amortized cost	(69,401)	(194,745)
Net change in deposits	42,834	156,388
Interest received	131,136	121,197
Interest paid	(65,276)	(49,954)
Issuance of member deposit shares	208	204
Redemption of member deposit shares	(986)	(255)
Dividends paid	(173)	(151)
Change in other assets and retirement benefit asset	(144)	2,441
Net change in derivative financial instruments	1,786	1,647
Change in other liabilities and retirement benefit obligation	3,442	(4,655)
Income taxes paid	(193)	(972)
Other items	(2,965)	(7,003)
	(24,630)	(56,615)
Investing activities		
Investment in term deposits	(46,796)	(21,000)
Proceeds from maturity of term deposits	35,423	37,671
Purchase of investments	(377,470)	(281,064)
Proceeds from the sale and maturity of investments	364,405	261,978
Additions to property, premises, equipment and intangibles	(813)	(1,931)
	(25,251)	(4,346)
Financing activities		
Proceeds from borrowed funds	55,000	45,000
Proceeds from securitization transactions	74,265	146,880
Proceeds (net) from securitization transactions (derecognized)	24,749	-
Principal elements of lease payments	(3,394)	-
Repayments of borrowed funds	(45,000)	(28,536)
Repayments of secured borrowings	(89,585)	(61,703)
Redemption of members' equity shares	(3,059)	(154)
	12,976	101,487
(Decrease) increase in cash and cash equivalents	(36,905)	40,526
Cash and cash equivalents – Beginning of year	48,156	7,630
Cash and cash equivalents – End of year	11,251	48,156
Cash and cash equivalents consist of:		
Demand deposits and clearings with Central 1	9,251	25,156
Term deposits with Central 1 with less than 90 days to maturity	2,000	23,000
	11,251	48,156

The accompanying notes are an integral part of these consolidated financial statements.

(expressed in thousands of dollars)

1 General information

Prospera Credit Union (the Credit Union) is incorporated under the Credit Union Incorporation Act of British Columbia and its operations are subject to the Financial Institutions Act of British Columbia (the FIA). The Credit Union's primary business activities include providing financial services to its members and the general public across British Columbia. It provides Personal Banking, Business Banking and Wealth Management services through a network of 16 branches, online and mobile banking, the Exchange ATM network and a contact centre.

The Credit Union is domiciled in Canada and its registered office is at #500 – 32071 S. Fraser Way, Abbotsford, British Columbia.

The consolidated financial statements have been approved for issue by the Board of Directors (the Board) on March 13, 2020.

2 Basis of presentation

a) Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) using applicable IFRS as well as the regulations of the FIA. The accounting policies applied in these consolidated financial statements are based upon IFRS for the year ended December 31, 2019, as issued and effective.

b) Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis, except for those instruments which fall under the standard of IFRS 9 – Financial Instruments (IFRS 9). Under IFRS 9, the Credit Union classifies its financial assets in the following measurement categories: Fair value through profit or loss (FVTPL), fair value through other comprehensive income (FVOCI), or amortized cost. Financial liabilities are accounted for at FVTPL and all derivative financial instruments are measured at fair value.

c) Functional and presentation currency

These consolidated financial statements are presented in Canadian dollars, which is also the Credit Union's functional currency. The figures shown in the consolidated financial statements are expressed in thousands of dollars, unless otherwise stated.

(expressed in thousands of dollars)

d) Use of estimates and judgments

The preparation of the consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from those estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised and in any future periods affected.

Information on significant areas of uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amounts recognized in the consolidated financial statements are described in note 5.

3 Changes in accounting policy

The Credit Union has adopted IFRS 16 as issued by the IASB in January 2016 with a date of transition of January 1, 2019, which resulted in changes in accounting policies and adjustments to the amounts previously recognized in the consolidated financial statements.

As permitted by the transitional provisions of IFRS 16, the Credit Union elected not to restate comparative figures. The reclassifications and the adjustments arising from the new leasing rules are therefore recognized in the opening consolidated statement of financial position on January 1, 2019. In applying IFRS 16 for the first time, the Credit Union has used the following practical expedients permitted by the standard:

a) applying a single discount rate to a portfolio of leases with reasonably similar characteristics

b) relying on previous assessments on whether leases are onerous as an alternative to performing an impairment review – there were no onerous contracts as at January 1, 2019

c) accounting for operating leases with a remaining lease term of less than 12 months as at January 1, 2019 as short-term leases

d) excluding initial direct costs for the measurement of the right-of-use asset at the date of initial application, and

e) using hindsight in determining the lease term where the contract contains options to extend or terminate the lease.

The Credit Union has also elected not to reassess whether a contract is, or contains a lease at the date of initial application. Instead, for contracts entered into before the transition date the Credit Union relied on its assessment by applying International Accounting Standards (IAS) 17 – Leases, and IFRS Interpretations Committee (IFRIC) 4 – Determining Whether an Arrangement Contains a Lease.

(expressed in thousands of dollars)

The adoption of IFRS 16 has resulted in changes in the Credit Union's accounting policies for recognition, classification and measurement in relation to leases which had previously been classified as 'operating leases' under the principles of IAS 17 – Leases. These liabilities were measured at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate as of January 1, 2019. The weighted average lessee's incremental borrowing rate applied to the lease liabilities on January 1, 2019 was 3.5%.

a) Measurement of lease liabilities

	$
Operating lease commitments disclosed at December 31, 2018 ($19,985) discounted using the lessee's incremental borrowing rate of 3.5% at the date of initial application	17,766
Less short-term leases not recognized as a liability	(125)
Less non-lease components not included in lease obligation calculation under IFRS 16	(4,216)
Lease liability recognized as at January 1, 2019 (note 14)	13,425
Current lease liabilities	3,323
Non-current lease liabilities	10,102

b) Measurement of right-of-use assets

The associated right-of-use assets for property leases were measured on a retrospective basis as if the new rules had always been applied. Right-of-use assets were measured at the amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognized in the consolidated statement of financial position as at January 1, 2019.

c) Adjustments recognized in the consolidated statement of financial position on January 1, 2019

The change in accounting policy affected the following items in the consolidated statement of financial position on January 1, 2019:

i) Right-of-use assets – increase by $13,425 (note 11)

ii) Lease liabilities – increase by $13,425 (note 14)

The net impact on retained earnings on January 1, 2019 was $nil.

(expressed in thousands of dollars)

4 Summary of significant accounting policies

a) Consolidation

The Credit Union consolidates investees when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

The Credit Union consolidates the following investees in which it has control as wholly owned subsidiaries. Its wholly owned subsidiaries are Prospera Insurance Agencies Ltd., Prospera Technologies Inc., 413297 B.C. Ltd., and Prospera Holdings Ltd.

Intercompany balances, and income and expenses arising from intercompany transactions, are eliminated in preparing the consolidated financial statements. Intercompany losses are also eliminated unless the transaction provides evidence of impairment of the asset transferred.

b) Foreign currency translation

Transactions in foreign currencies are translated to the functional currency of the Credit Union at the exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to the functional currency at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between the amortized cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortized cost in the foreign currency translated at the exchange rate at the end of the reporting period. Foreign currency differences arising on translation are recognized in the consolidated statement of income. Non-monetary items that are measured at historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary items in a foreign currency that are measured at fair value are translated using the exchange rates at the date when the fair value was determined.

c) Cash resources

Cash and cash equivalents include highly liquid balances with less than 90 days to maturity from the original date of issuance and include temporary clearing items. Interest bearing deposits include deposits with Central 1 Credit Union (Central 1).

d) Financial assets and liabilities – categorization, measurement and recognition

Management determines the classification of its financial instruments at initial recognition. The Credit Union uses trade date accounting for regular way contracts when recording financial asset transactions.

(expressed in thousands of dollars)

Measurement methods

Amortized cost and effective interest rate

The amortized cost is the amount at which the financial asset or financial liability is measured at initial recognition minus the principal repayments, plus or minus the cumulative amortization using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any loss allowance.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset (i.e. its amortized cost before any impairment allowance) or to the amortized cost of a financial liability. The calculation does not consider expected credit losses and includes transaction costs, premiums or discounts and fees and points paid or received that are integral to the effective interest rate, such as origination fees. When the Credit Union revises the estimates of future cash flows, the carrying amount of the respective financial asset or financial liability is adjusted to reflect the new estimate discounted using the original effective interest rate. Any changes are recognized in net income.

Interest income

Interest income is calculated by applying the effective interest rate to the gross carrying amount of financial assets, except for financial assets that have subsequently become credit-impaired (or stage 3), for which interest income is calculated by applying the effective interest rate to their amortized cost (i.e. net of the expected credit loss provision).

Initial recognition and measurement

Financial assets and financial liabilities are recognized when the entity becomes a party to the contractual provisions of the instrument. Regular way purchases and sales of financial assets are recognized on the trade date, the date on which the Credit Union commits to purchase or sell the asset.

At initial recognition, the Credit Union measures a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at FVTPL, transaction costs that are incremental and directly attributable to the acquisition or issue of the financial asset or financial liability, such as fees and commissions. Transaction costs of financial assets and financial liabilities carried at FVTPL are expensed in net income. Immediately after initial recognition, an expected credit loss allowance (ECL) is recognized for financial assets measured at amortized cost and investments in debt instruments measured at FVOCI, which results in an accounting loss being recognized in net income when an asset is newly originated.

When the fair value of financial assets and liabilities differs from the transaction price on initial recognition, the difference is deferred if the fair value is not determined using only observable inputs and the timing of recognition of deferred day one profit or loss is determined individually. It is either amortized over the life of the instrument, deferred until the instrument’s fair value can be determined using market observable inputs, or realized through settlement.

(expressed in thousands of dollars)

Financial assets

Classification and subsequent measurement

The Credit Union classifies its financial assets in the following measurement categories:

- Fair value through profit or loss (FVTPL);
- Fair value through other comprehensive income (FVOCI); or
- Amortized cost.

The classification requirements for debt and equity instruments are described below:

Debt instruments

Debt instruments are those instruments that meet the definition of a financial liability from the issuer's perspective and would include interest bearing deposits, loans and other investments held by the Credit Union.

Classification and subsequent measurement of debt instruments depend on:

- the business model for managing the asset; and
- the cash flow characteristics of the asset.

Based on these factors, the Credit Union classifies its debt instruments into one of the following three measurement categories:

- Amortized cost: Financial assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest (SPPI), and that are not designated at FVTPL, are measured at amortized cost. The carrying amount of these assets is adjusted by any ECL allowance recognized and measured as described in note 6. Interest income from these financial assets is included in loans and receivables measured at amortized cost in the consolidated statement of income using the effective interest rate method.

- FVTPL: Financial assets that do not meet the criteria for amortized cost or FVOCI are measured at FVTPL. A gain or loss on a debt investment that is subsequently measured at FVTPL and is not part of a hedging relationship is recognized in net income and presented in the consolidated statement of income and comprehensive income within other income in the period in which it arises. Interest income from these financial assets is included in financial instruments measured at fair value through profit and loss in the consolidated statement of income.Interest income was calculated using the customer coupon rate.

(expressed in thousands of dollars)

- FVOCI: Financial assets that are held for collection of contractual cash flows and for selling the assets, where the assets' cash flows represent SPPI and that are not designated at FVTPL, are measured at FVOCI. Movements in the carrying amount are taken through other comprehensive income (OCI), except for the recognition of impairment gains or losses, interest revenue and foreign exchange gains and losses on the instrument's amortized cost, which are recognized in net income. When the financial asset is derecognized, the cumulative gain or loss previously recognized in OCI is reclassified from equity to net income and recognized in net interest income. Interest income from these financial assets is included in net interest income using the effective interest rate method.

Business model

The business model reflects how the Credit Union manages the assets in order to generate cash flows. That is, whether the Credit Union's objective is solely to collect the contractual cash flows from the assets or is to collect both the contractual cash flows and cash flows arising from the sale of assets. If neither of these is applicable (e.g. financial assets are held for trading purposes), then the financial assets are classified as part of 'other' business model and measured at FVTPL. Factors considered by the Credit Union in determining the business model for a group of assets include past experience on how the cash flows for these assets were collected, how the asset's performance is evaluated and reported to key management personnel, how risks are assessed and managed and how managers are compensated.

SPPI

Where the business model is to hold assets to collect contractual cash flows or to collect contractual cash flows and sell, the Credit Union assesses whether the financial instruments' cash flows represent SPPI. In making this assessment, the Credit Union considers whether the contractual cash flows are consistent with a basic lending arrangement (i.e. interest includes only consideration for the time value of money, credit risk, other basic lending risks and a profit margin that is consistent with a basic lending arrangement). Where the contractual terms introduce exposure to risk or volatility that are inconsistent with a basic lending arrangement, the related financial asset is classified and measured at FVTPL.

Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are SPPI.

The Credit Union reclassifies debt investments when and only when its business model for managing those assets changes. The reclassification takes place from the start of the first reporting period following the change. Such changes are expected to be very infrequent and none occurred during the period.

Equity instruments

Equity instruments are instruments that meet the definition of equity from the issuer's perspective; that is, instruments that do not contain a contractual obligation to pay and that evidence a residual interest in the issuer's net assets. Examples of equity instruments include the Credit Union's investment in shares of Central 1.

(expressed in thousands of dollars)

The Credit Union subsequently measures all equity investments at FVTPL, except where the Credit Union's management has elected, at initial recognition, to irrevocably designate an equity investment at FVOCI. The Credit Union's policy is to designate equity investments as FVOCI when those investments are held for purposes other than to generate investment returns. When this election is used, fair value gains and losses are recognized in OCI and are not subsequently reclassified to net income, including on disposal. Impairment losses (and reversal of impairment losses) are not reported separately from other changes in fair value. Dividends, when representing a return on such investments, continue to be recognized in net income as other income when the Credit Union's right to receive payments is established.

The Credit Union has not classified any equity instruments at FVTPL.

Impairment

The Credit Union assesses on a forward-looking basis the ECL associated with its assets carried at amortized cost and FVOCI and with the exposure arising from loan commitments and financial guarantee contracts. The Credit Union recognizes a loss allowance for such losses at each reporting date. The measurement of ECL reflects:

- An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes:

  i) the time value of money;

  ii) reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions; and

  iii) note 25 provides more detail of how the ECL allowance is measured.

Modification of loans

The Credit Union sometimes renegotiates or otherwise modifies the contractual cash flows of loans to customers. When this happens, the Credit Union assesses whether or not the new terms are substantially different to the original terms. The Credit Union does this by considering, among others, the following factors:

i) if the borrower is in financial difficulty, whether the modification merely reduces the contractual cash flows to amounts the borrower is expected to be able to pay;

ii) whether any substantial new terms are introduced, such as a profit share/equity-based return that substantially affects the risk profile of the loan;

iii) significant extension of the loan term when the borrower is not in financial difficulty;

iv) significant change in the interest rate;

(expressed in thousands of dollars)

v) change in the currency the loan is denominated in; or

vi) insertion of collateral, other security or credit enhancements that significantly affect the credit risk associated with the loan.

If the terms are substantially different, the Credit Union derecognizes the original financial asset and recognizes a new asset at fair value and recalculates a new effective interest rate for the asset. The date of renegotiation is consequently considered to be the date of initial recognition for impairment calculation purposes, including for the purpose of determining whether a significant increase in credit risk has occurred. However, the Credit Union also assesses whether the new financial asset recognized is deemed to be credit-impaired at initial recognition, especially in circumstances where the renegotiation was driven by the debtor being unable to make the originally agreed upon payments. Differences in the carrying amount are also recognized in net income as a gain or loss on derecognition.

If the terms are not substantially different, the renegotiation or modification does not result in derecognition, and the Credit Union recalculates the gross carrying amount based on the revised cash flows of the financial asset and recognizes a modification gain or loss in net income. The new gross carrying amount is recalculated by discounting the modified cash flows at the original effective interest rate.

Derecognition other than on a modification

Financial assets, or a portion thereof, are derecognized when the contractual rights to receive the cash flows from the assets have expired, or when they have been transferred and either (i) the Credit Union transfers substantially all the risks and rewards of ownership, or (ii) the Credit Union neither transfers nor retains substantially all the risks and rewards of ownership and the Credit Union has not retained control.

The Credit Union, through securitizations, periodically transfers loans to independent third parties. Where the Credit Union's securitizations and other transfers of receivables do not result in a transfer of contractual cash flows of the receivables or an assumption of an obligation to pay the cash flows of the receivables to a transferee, the Credit Union does not derecognize the transferred receivables and instead records a secured borrowing with respect to any consideration received.

(expressed in thousands of dollars)

Financial liabilities

The Credit Union designates amounts drawn on lines of credit, accounts payable, secured borrowings, deposits, financial guarantee contracts and loan commitments and derivative financial instruments as financial liabilities. In both the current and prior period, financial liabilities are initially recognized at fair value and subsequently measured at amortized cost using the effective interest rate method except for derivative financial instruments, financial guarantee contracts and loan commitments and certain secured borrowings. Financial liabilities are derecognized when they are extinguished (i.e. when the obligation specified in the contract is discharged, cancelled or expires).

Financial liabilities at FVTPL

A financial liability is required to be classified as FVTPL if it is incurred principally for the purpose of repurchasing it in the near term or if it is part of a portfolio of identified financial liabilities that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. Derivative liabilities are also categorized as FVTPL unless they are designated and are effective hedging instruments in a hedge accounting relationship. Gains and losses on FVTPL financial liabilities are recorded in net income.

The Credit Union's financial liabilities classified as FVTPL consist of derivative financial instruments, and certain secured borrowings have also been designated as FVTPL in order to reduce a reporting mismatch that would arise if such borrowing were recorded at amortized cost. Where the Credit Union has designated a liability as FVTPL, any portion of a change in fair value that is due to changes in own credit risk are recorded through OCI.

e) Derivatives and hedging activities

The Credit Union has elected to continue to apply the hedge accounting requirements of IAS 39 on adoption of IFRS 9. Derivatives are initially recognized at fair value on the date on which the derivative contract is entered into and are subsequently remeasured at fair value. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

The method of recognizing the resulting fair value gain or loss depends on whether the derivative is designated and qualifies as a hedging instrument, and if so, the nature of the item being hedged. The Credit Union designates certain derivatives as either:

i) hedges of the fair value of recognized assets or liabilities or firm commitments (fair value hedges); or

ii) hedges of highly probable future cash flows attributable to a recognized asset or liability (cash flow hedges).

(expressed in thousands of dollars)

The Credit Union documents, at the inception of the hedge, the relationship between hedged items and hedging instruments, as well as its risk management objective and strategy for undertaking various hedge transactions. The Credit Union also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the consolidated statement of net income and comprehensive income, together with changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used is amortized to net income over the period to maturity and recorded as interest income.

Cash flow hedge

The effective portion of changes in fair value of derivatives that are designated and qualify as cash flow hedges is recognized in OCI. The gain or loss relating to the ineffective portion is recognized immediately in the consolidated statement of income and comprehensive income.

Amounts accumulated in equity are recycled to the consolidated statement of income and comprehensive income in the periods when the hedged item affects profit or loss. They are recorded in the income or expense lines in which the revenue or expense associated with the related hedged item is reported.

When a hedged instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognized in the periods when the hedged item affects profit or loss. When a forecast transaction is no longer expected to occur (for example, the recognized hedged asset is disposed of), the cumulative gain or loss previously recognized in OCI is immediately reclassified to the consolidated statement of income and comprehensive income.

f) Property held for resale

In certain circumstances, the Credit Union may take possession of property held as collateral as a result of foreclosure on loans that are in default. Foreclosed properties where the Credit Union has taken possession are classified as assets held for sale and are measured at the lower of the carrying amount and the fair value less costs to sell.

The Credit Union does not, as a rule, occupy repossessed properties for its business use. These assets are normally sold in a manner that maximizes the benefit to the Credit Union, the member and the member’s other creditors, and may involve the use of realtors.

No properties were held for resale as at the end of 2019 or 2018.

(expressed in thousands of dollars)

g) Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the consolidated statement of financial position when there is a legally enforceable right to offset the recognized amounts with the same counterparty and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

h) Fee and commission income

The accounting treatment for loan fees varies depending on the transaction. Fees that are considered to be adjustments to loan yield are recognized using the effective interest method. The effective interest method capitalizes fees and transaction costs on the consolidated statement of financial position and amortizes them to interest income over the expected life of the related loan. Mortgage prepayment fees are recognized in interest income when received, unless they relate to a minor modification to the terms of the mortgage, in which case the fees are recognized over the expected remaining term of the original mortgage using the effective interest method. Loan origination, restructuring and renegotiation fees for loans are recorded as interest income over the expected term of the loan using the effective interest method. Commitment fees are recorded in interest income over the expected term of the loan, unless the loan commitment is not expected to be used, in which case they are recorded to other income. Loan discharge and administration fees are recorded directly to other income when the loan transaction is complete.

Loan fees that are recognized using the effective interest method are included with loan balances on the consolidated statement of financial position.

Service charges and foreign exchange transaction fees are recognized on an accrual basis when the service is performed.

Commission income is earned on the sale of insurance policies and is recognized as at the related insurance policy's effective date. The Credit Union may receive additional commissions from insurance companies, which are recorded at the earlier of the period in which amounts can be reliably measured or the period in which the amounts are received.

Investment management fees, mutual fund fees and financial planning fees are recorded on an accrual basis upon performance of services.

i) Impairment of non-financial assets

Assets that have an indefinite useful life are not subject to amortization and are tested annually for impairment. Assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash generating units). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

(expressed in thousands of dollars)

j) Property, premises and equipment

i) Recognition and measurement

All premises and equipment used by the Credit Union are measured at historical cost less accumulated depreciation and accumulated impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

ii) Right-of-use assets

Right-of-use assets arising from a lease are initially measured on a present value basis. Right-of-use assets are measured at cost comprising the following:

- the amount of the initial measurement of lease liability
- any lease payments made at or before the commencement date less any lease incentives received
- any initial direct costs

iii) Subsequent costs

Subsequent expenditures are included in the asset's carrying amount or are recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Credit Union and the cost of the item can be reliably measured.

All repair and maintenance costs are charged to the consolidated statement of income during the financial period in which they are incurred.

iv) Depreciation

Land is carried at cost and is not depreciated. Asset classes are further categorized for depreciation where significant differences in the estimated useful life of the various components of individually significant assets are identified. Depreciation is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives, as follows:

Buildings and betterments	7 to 30 years
Leasehold improvements	3 to 10 years
Equipment	3 to 10 years
Right-of-use assets	5 to 20 years

The residual values and useful lives of premises and equipment are reviewed, and adjusted if appropriate, at each consolidated statement of financial position date. Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

Right-of-use assets are generally depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis. If the Credit Union is reasonably certain to exercise a purchase option where it exists, the right-of-use asset is depreciated over the underlying asset's useful life.

(expressed in thousands of dollars)

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and value in use.

Gains and losses on disposals are determined by comparing proceeds with the carrying amount and are included in the consolidated statement of income.

k) Intangibles

Computer software is capitalized when the future economic benefit is expected to exceed a period of one year. Otherwise, software costs are expensed when incurred. Capitalized software costs are initially recognized at cost and amortized using the straight-line method over the expected useful life. The expected useful life ranges from three to 10 years.

l) Leases

As of January 1, 2019 upon of adoption of IFRS 16, assets and liabilities arising from a lease are initially measured on a present value basis. Lease liabilities include the net present value of the fixed lease payments. Lease payments to be made under reasonably certain extension options are also included in the measurement of the liability.

Lease payments are allocated between principal and interest expense. The interest expense is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

Payments associated with short-term leases and all leases of low-value assets are recognized on a straight-line basis as an expense in profit or loss. Short-term leases are leases with a lease term of 12 months or less. Low-value assets comprise IT equipment and small items of office furniture.

Prior to January 1, 2019 and the adoption of IFRS 16, leases were classified in accordance with IAS 17 – Leases, whereby the economic ownership of a leased asset is transferred to the lessee if the lessee bears substantially all the risks and rewards related to the ownership of the leased asset. In some cases, the lease transaction is not always conclusive, and management uses judgment in determining whether the lease is a finance lease arrangement that transfers substantially all the risks and rewards incidental to ownership. If this determination is positive, the related asset is then recognized by the lessee at the inception of the lease at an amount equal to the lower of its fair value and the present value of the minimum lease payments. A corresponding amount is recognized as a finance lease liability.

Prior to January 1, 2019, all of the Credit Union's lease agreements were classified as operating leases. Payments on operating lease agreements are recognized as an expense on a straight-line basis over the lease term. Associated costs such as maintenance and insurance are expensed as incurred.

(expressed in thousands of dollars)

m) Income tax

Income tax expense comprises current and deferred taxes. Current and deferred taxes are recognized in the consolidated statement of income except to the extent that they relate to items recognized directly in members' equity or in other comprehensive income.

i) Current income tax

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

ii) Deferred income tax

Deferred tax is recognized with respect to temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities against current tax assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences to the extent that it is probable that future taxable income will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

n) Employee benefits

The Credit Union operates various pension plans. The plans are generally funded through contributions to trustee-administered funds determined by periodic actuarial calculations. The Credit Union has both defined benefit and defined contribution plans.

i) Defined benefit pension plans

A defined benefit pension plan typically defines an amount of a pension benefit that an employee will receive on retirement, usually dependent upon one or more factors, such as age, years of service and compensation. The actuarial and investment risks of a defined benefit plan are typically primarily the responsibility of the sponsor of the plan.

(expressed in thousands of dollars)

The Credit Union uses the projected unit credit method to determine the present value of its defined benefit pension obligations and the related current service cost and, where applicable, past service cost. The defined benefit obligation is calculated on an annual basis by the appointed independent actuary to the respective defined benefit plans. This requires the Credit Union to determine the benefit attributable to the current and prior periods and to make estimates about demographic and financial variables that will affect the ultimate cost of the benefit. The present value of the defined benefit obligation of the respective plan is determined by discounting the estimated future cash flow outflows using interest rates of high quality corporate bonds that are denominated in Canadian dollars and that have terms to maturity approximating the terms of the respective related defined benefit plan liability.

For funded plans, the Credit Union recognizes the fair value of the plan assets in accordance with the requirements of IFRS 13 for fair value measurements. Financial instruments such as quoted equities are valued using closing prices.

The fair value of any plan assets is deducted from the present value of the defined benefit obligation in determining the deficit or surplus on an individual plan basis. If a plan surplus exists, the fair value of the plan assets recognized on the Credit Union's consolidated statement of financial position is limited to the amount from which the Credit Union can derive a future economic benefit.

The Credit Union recognizes the service cost of the respective plans in salaries and employee benefits. The service cost principally comprises the current service cost representing the increase in the present value of the defined benefit obligation from employee service in the current period and the past service cost representing the changes in the present value of the defined benefit obligation from a plan amendment or curtailment.

The Credit Union recognizes the net interest on the defined benefit liability (asset) directly in the consolidated statement of income.

Remeasurements of the defined benefit asset (obligation) are recognized immediately in other comprehensive income and are transferred into other reserves within the consolidated statement of changes in members' equity. Remeasurements principally consist of actuarial gains and losses, the return on plan assets excluding amounts incorporated into the net interest on the net defined benefit asset (obligation) and any change in the effect of the asset ceiling, excluding amounts included in net interest on the net defined benefit asset (obligation).

ii) Post-employment health care benefits

The Credit Union operates a post-employment health care benefit plan. The method of accounting, assumptions and the frequency of valuations are similar to those used for defined benefit pension plans.

(expressed in thousands of dollars)

iii) Defined contribution pension plans

For defined contribution plans, the Credit Union pays a specified flat rate for employer contributions. The Credit Union has no further payment obligations once the contributions have been paid. The contributions are recognized as an employee benefit expense on an accrual basis in the periods during which services are rendered by employees.

iv) Participation in multi-employer pension plan

The Credit Union provides defined retirement benefits to certain employees through a multi-employer plan administered by Central 1. There are two divisions within this multi-employer plan, a 1.75% division and a 1.20% division. The Credit Union is the only remaining participant in the 1.20% division of the plan, whereas a number of member credit unions continue to participate in the 1.75% division of the plan. Within these consolidated financial statements, the Credit Union accounts for the 1.75% division of the plan as a defined contribution pension plan, and the 1.20% division of the plan as a defined benefit pension plan.

Each member credit union of the 1.75% division of the multi-employer plan is exposed to the actuarial risks of the other employers with the result that, in the Credit Union's opinion, there is no reasonable way to allocate any defined benefit obligations. As this is a multi-employer plan, the assets and liabilities are pooled and assets are not tracked separately by the participating employer. Although the actuaries may be able to determine a breakdown of the current liabilities based on each employer's individual demographic profile and allocate a proportionate share of the assets based on the solvency ratio of the entire plan, the plan does not track accumulated contributions and investment earnings for each employer. As this is a multi-employer plan, the plan exposes individual participating employers to the common actuarial risks of all of the defined benefit plan members within the 1.75% division. As a result, the Credit Union is not able to determine the extent to which it may be liable to the plan for other member entities' obligations under the terms and conditions of the plan. There is also no indication of the level of participation in the plan by the Credit Union compared with other participating entities. Accordingly, the Credit Union's participation in the 1.75% division of the plan is accounted for as a defined contribution plan with contributions recorded on an accrual basis. The Credit Union has provided additional disclosure on the overall funding status of the multi-employer plan and future contribution levels in note 17(h).

o) Related parties

A related party is a person or an entity that is related to the Credit Union.

i) A person or a close member of that person's family is related to the Credit Union if that person:

- has control or joint control over the Credit Union, with the power to govern the Credit Union's financial and operating policies;
- has significant influence over the Credit Union, participating in financial or operating policy decisions, but not control over these policies; or

(expressed in thousands of dollars)

- is a member of the key management personnel of the Credit Union. Key management personnel, consistent with the definition under IAS 24 – Related Party Disclosures, are persons having authority and responsibility for planning, directing and controlling the activities of the Credit Union, directly or indirectly. Key management personnel for the Credit Union comprises the Board and executive management.

An entity is related to the Credit Union if any of the following conditions apply:

- the entity and the Credit Union are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others);
- one entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group, of which the other entity is a member);
- both entities are joint ventures of the same third party;
- one entity is a joint venture of a third entity and the other entity is an associate of the third entity;
- the entity is a post-employment benefit plan for the benefit of employees of either the Credit Union or an entity related to the Credit Union;
- the entity is controlled or jointly controlled by a person identified in (i) above; or
- a person identified in (i)(1) above has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

p) Provisions

A provision is recognized if, as a result of a past event, the Credit Union has a present legal or constructive obligation that can be estimated reliably and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

A provision for onerous contracts is recognized when the expected benefits to be derived by the Credit Union from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract. Before a provision is established, the Credit Union recognizes any impairment loss on the assets associated with the contract.

(expressed in thousands of dollars)

q) Equity and non-equity shares

Upon opening an account at the Credit Union, new members are required to purchase a minimum of 25 Class A Membership equity shares (junior members – five shares). Class A Membership equity shares are redeemable on demand by the member. Periodically, members may purchase Class F, G, H or I Preferred shares, as authorized by the Board, which are redeemable at the end of the time periods stated for that particular class of share. Accordingly, these classes of shares are recorded as member deposit shares.

Class A Membership, Class C Investment, Class D Insured, Class E Equity, and Preferred shares of the Credit Union are not subject to guarantee by the Credit Union Deposit Insurance Corporation of British Columbia (CUDIC). No Class H or I Preferred shares are issued. Dividends may be declared annually on Class A Membership, Class C Investment, Class E Equity and Preferred shares at the discretion of the Board.

Members, periodically, as authorized by the Board, are permitted to purchase Class C Investment and Class E Equity shares. Redemption of Class C Investment and Class E Equity shares is subject to certain conditions and approval of the Board. Accordingly, they are recorded as members' equity.

r) Standards and interpretations issued but not yet effective

A number of standards and interpretations, and amendments thereto, have been issued by the IASB that are not effective for these consolidated financial statements. The Credit Union has not adopted any standards that are not yet effective but are eligible for early adoption. There are no such standards that will have a significant effect on the Credit Union's consolidated financial statements.

5 Critical accounting estimates and judgments

The preparation of consolidated financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Credit Union's accounting policies. Changes in assumptions may have a significant impact on the consolidated financial statements in the period the assumptions changed. The principal areas involving a higher degree of judgment or complexity and/or areas which may result in significant changes in estimates are described below:

a) Measurement of the ECL allowance

The Credit Union regularly reviews its loan portfolio to assess the ECL allowance for loans. The measurement of the ECL allowance for financial assets measured at amortized cost and FVOCI is an area that requires the use of complex models and significant assumptions about future economic conditions and credit behaviour (e.g. the likelihood of customers defaulting and the resulting losses). Explanation of the inputs, assumptions and estimation techniques used in measuring ECL is further detailed in note 25, which also sets out key sensitivities of the ECL to changes in these elements.

(expressed in thousands of dollars)

A number of significant judgments are also required in applying the accounting requirements for measuring ECL, such as:

i) determining criteria for significant increase in credit risk (SICR);

ii) choosing appropriate models and assumptions for the measurement of ECL;

iii) establishing the number and relative weightings of forward-looking scenarios for each type of product and the associated ECL; and

iv) establishing groups of similar financial assets for the purposes of measuring ECL.

Classification and measurement

A number of significant judgements are required in applying the accounting requirements for the appropriate classification and measurement under IFRS 9 such as determining if the SPPI test has been met, specifically the evaluation of the prepayment feature in the consumer loan portfolio.

b) Fair values of financial instruments

The fair values of financial instruments where no active market exists or where quoted prices are not otherwise available are determined using specific valuation techniques. In these cases, the fair values are estimated from observable data in respect of similar financial instruments or by using models. Where market observable inputs are not available, they are estimated based on appropriate assumptions. Where valuation techniques are used to determine fair values, they are validated and periodically reviewed by management. To the extent practicable, models make maximum use of market observable data; however, areas such as credit risk (both the Credit Union's credit risk and counterparty risk) and correlations require management to make estimates.

Included in the results reported for the years ended December 31, 2019 and 2018 is the assessed fair value of a portfolio of personal loans which was estimated based on a valuation technique using multiple assumptions as described in note 7. This portfolio was classified and measured at fair value under IFRS 9 based on the cash flow characteristics of the asset.

The Credit Union has disclosed the fair values of financial instruments in note 28.

(expressed in thousands of dollars)

c) Retirement benefits

The present value of retirement benefit obligations depends on a number of factors that are determined on an actuarial basis using a number of assumptions. Any changes in these assumptions will impact the carrying amount of pension obligations.

One of the assumptions used in determining the net cost for retirement benefit plans is the discount rate. The Credit Union determines the appropriate discount rate at the end of each year. This is the interest rate that should be used to determine the present value of estimated future cash outflows expected to be required to settle the pension obligations. In determining the appropriate discount rate, the Credit Union considers the interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid and that have terms to maturity approximating the terms of the related pension liability. Other key assumptions for pension obligations are based in part on current market conditions. The Credit Union has provided additional disclosures concerning the accounting of retirement benefits during the year in note 17.

d) Leases

The lease payments are discounted using the interest rate implicit in the lease. If that rate cannot be readily determined, which is generally the case for leases in the Credit Union, the lessee's incremental borrowing rate is used, being the rate that the individual lessee would have to pay to borrow the funds necessary to obtain an asset of similar value to the right-of-use asset in a similar economic environment with similar terms, security and conditions.

To determine the incremental borrowing rate, the Credit Union:

- where possible, uses recent third-party financing received by the individual lessee as a starting point, adjusted to reflect changes in financing conditions since third party financing was received
- uses a build-up approach that starts with a risk-free interest rate adjusted for credit risk for leases, and
- makes adjustments specific to the lease, for example the term, country, currency and security.

(expressed in thousands of dollars)

e) Income taxes

The Credit Union computes an effective tax rate which includes an evaluation of the current and future availability of the credit union deduction under the Canadian Income Tax Act and the small business income tax rate under the British Columbia Income Tax Act. The credit union deduction and the BC small business income tax rate apply to credit unions on taxable income of a credit union until such time as 4/3 of 5% of the amounts owing to members (including deposits, members' shares and other borrowings) (the maximum cumulative reserve) exceeds the cumulative taxable income that was previously subject to the credit union deduction (the preferred rate amount) of a credit union. An estimate of future deposit, member borrowing, share and income growth is based on the modeling of the Credit Union's business plan, inclusive of economic indicators, and provides the basis in determining the availability of the credit union deduction and the credit union small business income tax rate.

In 2013, the Canadian Income Tax Act was amended to phase out the credit union deduction available to credit unions over five years. The preferential treatment was scheduled to be reduced to 80% for 2016, 60% for 2017, 40% for 2018, 20% for 2019 and 0% for 2020 and later years. In 2017, a further amendment was made to restore the preferential treatment in full, specific to the BC income tax rate effective January 1, 2017.

The credit union deduction and the BC small business income tax rate are taken into account to determine the effective tax rate used in computing the income tax provision. However, the actual amounts of income tax expense do not become known until the filing with and assessment of the income tax return by the relevant tax authorities, which occurs subsequent to the issuance of the consolidated financial statements. To the extent that estimates differ from the final tax returns, net income would be affected in the subsequent year.

The Credit Union periodically assesses its liabilities and contingencies related to income taxes for all years open to audit based on the latest information available. For matters where it is probable that an adjustment will be made, the Credit Union records its best estimate of the tax liability including the related interest and penalties in the current tax provision. The Credit Union has disclosed the accounting treatment for income tax for the year in note 23.

(expressed in thousands of dollars)

6 Loans

	2019 $	2018 $
Personal Banking		
Residential mortgages	1,963,748	1,991,149
Loans – measured at amortized cost	232,523	235,766
Loans – measured at fair value (note 7)	68,093	96,299
Business Banking mortgages and loans	969,100	857,313
Net deferred transaction fees and related costs	261	2,776
Accrued interest	5,927	5,291
	3,239,652	3,188,594
Less: Allowance for credit losses	(5,083)	(4,834)
	3,234,569	3,183,760
Current	1,125,015	1,093,443
Non-current	2,109,554	2,090,317

At December 31, 2019, loans measured at amortized cost are presented net of allowances for expected credit losses totalling 5,083 (2018 – $4,834).

The following table contains an analysis of the credit risk exposure of financial instruments for which an ECL allowance is recognized. The gross carrying amount of financial assets below also represents the Credit Union's maximum exposure to credit risk on these assets. The Credit Union has also considered credit risk associated with off-balance sheet commitments in the calculation of the ECL model and determined these to be insignificant.

				2019
	Stage 1 12-month ECL $	Stage 2 Lifetime ECL $	Stage 3 Lifetime ECL $	Total $
Personal banking mortgages and loans	605	843	191	1,639
Business banking mortgages and loans	1,038	984	1,422	3,444
	1,643	1,827	1,613	5,083
Gross carrying amount	3,119,515	33,237	12,618	3,165,370
Less: Loss allowance	1,643	1,827	1,613	5,083
	3,117,872	31,410	11,005	3,160,287

(expressed in thousands of dollars)

				2018
	Stage 1 12-month ECL $	Stage 2 Lifetime ECL $	Stage 3 Lifetime ECL $	Total $
Personal banking mortgages and loans	632	1,173	60	1,865
Business banking mortgages and loans	1,087	1,239	643	2,969
	1,719	2,412	703	4,834
Gross carrying amount	3,028,718	48,151	7,359	3,084,228
Less: Loss allowance	1,719	2,412	703	4,834
Carrying amount	3,026,999	45,739	6,656	3,079,394

Loss allowance

The loss allowance recognized in the period is impacted by a variety of factors, such as:

a) transfers between Stage 1 and Stage 2 or Stage 3 due to financial instruments experiencing significant increases or decreases of credit risk or becoming credit-impaired in the period, and the consequent step up or step down between 12-month and Lifetime ECL;

b) additional allowances for new financial instruments recognized during the period, as well as releases for financial instruments derecognized in the period;

c) impact on the measurement of ECL due to changes in PDs, EADs and LGDs in the period, arising from regular refreshing of inputs to models;

d) impacts on the measurement of ECL due to changes made to models and assumptions;

e) financial assets derecognized during the period and write-offs of allowances related to assets that were written off during the period.

For more information regarding the loss allowance calculation and the details for the transfers in staging can be found in the credit risk portion of note 25.

(expressed in thousands of dollars)

Reconciliation of allowance for credit losses

	2019 $	2018 $
Balance – Beginning of year	4,834	4,807
Loan write-offs (note 25)	(207)	(169)
Provision for credit losses	456	196
Balance – End of year	5,083	4,834

During the year, the Credit Union recorded recoveries of $109 (2018 – $46) on loans that have been previously written off. Such recoveries are included within provision for credit losses in the consolidated statement of income.

Write-off policy

The Credit Union writes off financial assets, in whole or in part, when it has exhausted all practical recovery efforts and has concluded there is no reasonable expectation of recovery. Indicators that there is no reasonable expectation of recovery include (i) ceasing enforcement activity and (ii) where the Credit Union's recovery method is foreclosing on collateral and the value of the collateral is such that there is no reasonable expectation of recovering in full.

The Credit Union may write off financial assets that are still subject to enforcement activity. The Credit Union still seeks to recover amounts it is legally owed in full, but which have been partially written off due to no reasonable expectation of full recovery.

Modification of financial assets

The Credit Union sometimes modifies the terms of loans provided to customers due to commercial renegotiations, or for distressed loans, with a view to maximizing recovery.

Such restructuring activities include extended payment term arrangements, payment holidays and payment forgiveness. Restructuring policies and practices are based on indicators or criteria which, in the judgment of management, indicate that payment will most likely continue. These policies are kept under continuous review. Restructuring is most commonly applied to term loans.

(expressed in thousands of dollars)

The risk of default of such assets after modification is assessed at the reporting date and compared with the risk under the original terms at initial recognition, when the modification is not substantial and so does not result in derecognition of the original asset. The Credit Union monitors the subsequent performance of modified assets. The Credit Union may determine that the credit risk has significantly improved after restructuring, so that the assets are moved from Stage 3 or Stage 2 (Lifetime ECL) to Stage 1 (12-month ECL). It was determined that there was no significant impact due to modifications as at December 31, 2019 or December 31, 2018.

The Credit Union continues to monitor if there is a subsequent significant increase in credit risk in relation to such assets through the use of specific models for modified assets where applicable.

7 Loans measured at fair value

Included in Loans on the consolidated statement of financial position and within the Personal Banking Loans segment (note 6) is a portfolio of loans measured at fair value of $68,093 (2018 – $96,299). Details on the balances are as follows:

		$
Balance at fair value – January 1, 2018		140,311
Principal payments received		(28,631)
Change in fair value measurement		
Current year write-off experience	(4,313)	
Variation in current year cash flow experience	(4,598)	
Change in risk assumptions	(6,470)	(15,381)
Balance at fair value – December 31, 2018		96,299
Principal payments received		(21,700)
Change in fair value measurement		
Current year write-off experience	(3,777)	
Change in risk assumptions and experience variation	(2,729)	(6,506)
Balance at fair value – December 31, 2019		68,093

The fair value of the portfolio is calculated by the Credit Union using a valuation model that considers the present value of the expected net cash flows to be generated from the loan portfolio, taking into account expected probability of default and prepayment and loss given default.

The principal assumptions used to calculate the fair value of the portfolio are as follows:

Assumption	2019 %	2018 %
Risk free rate	2.08	2.40
Portfolio specific spread	4.49	4.49
Probability of defaults based on loan vintage	0.00 to 1.74	0.0 to 2.30
Loss given default	90.00	100.00
Probability of prepayments depending on loan vintage	0.74 to 4.64	0.05 to 6.84

(expressed in thousands of dollars)

Sensitivity analysis

The sensitivity of the fair value measurement to changes in the principal assumptions presented below was performed by changing each assumption individually. If an actual change occurs, it is likely that some of these assumptions are correlated, which could change the combined impact.

	2019		2018	
Risk free rate	1% increase (decrease)	+/- $1,749	1% increase (decrease)	+/- $2,559
Portfolio specific spread	1% increase (decrease)	+/- $1,749	1% increase (decrease)	+/- $2,559
Probability of defaults based on loan vintage	0.7% increase (decrease)	+/- $1,083	0.7% increase (decrease)	+/- $1,547
Loss given default	10% increase (decrease)	+/- $114	10% increase (decrease)	+/- $375
Probability of prepayments depending on loan vintage	2.5% increase (decrease)	+/- $788	2.5% increase (decrease)	+/- $868

8 Loan securitizations and other transfers

Transferred financial assets that are not derecognized in their entirety

The Credit Union securitizes insured residential mortgages by participating in the National Housing Authority (NHA) Canada Mortgage Bond (CMB) and Mortgage-Backed Securities (MBS) programs. Through the programs, the Credit Union issues securities backed by residential mortgages that are insured against borrower's default. Once the mortgages are securitized, the Credit Union assigns underlying mortgages and/or related securities to Canada Mortgage and Housing Corporation (CMHC).

During the year, the Credit Union entered into transfer agreements which were reviewed in order to determine whether the transfers of financial assets should result in all or a portion of the transferred mortgages being derecognized from its consolidated statement of financial position. The derecognition requirements include an assessment of whether the Credit Union's rights to contractual cash flows have expired or have been transferred or whether an obligation has been undertaken by the Credit Union to pay the cash flows collected on the underlying transferred assets over to a third party. The derecognition standards also include an assessment of whether substantially all the risks and rewards of ownership have been transferred.

The Credit Union has determined that an amount of $74,265 (2018 – $146,880) raised from securitization transactions during the year should be accounted for as a secured borrowing as the Credit Union did not transfer substantially all of the risks and rewards of ownership, principally because it did not transfer prepayment, interest and credit risk of the mortgages in the securitization. At December 31, 2019, the Credit Union had $356,207 (2018 – $384,818) of residential mortgages which had been securitized and included on the consolidated statement of financial position as the securitization transactions did not meet the requirements for derecognition. The total carrying amount of the original loans securitized as at December 31, 2019 was $514,216 (2018 – $571,523) at the point of initial securitization. These loans are held as security for the secured borrowings (note 13). As a result of the transactions, the Credit Union receives the net differential between the monthly interest receipts of the mortgages and the interest expense on the borrowings. The exposure to variability of future interest income and expense has been incorporated into the Credit Union's interest rate sensitivity calculations in note 25.

(expressed in thousands of dollars)

The following table shows the carrying amounts of assets and liabilities relating to securitization transactions which have not been derecognized:

	Loans and receivables	
	2019 $	**2018** $
Carrying amount of assets	501,232	515,846
Carrying amount of associated liabilities	(505,307)	(520,103)
Carrying amount of derivatives	-	(5)
For those liabilities that have recourse only to the transferred assets:		
Fair value of assets	500,049	519,907
Fair value of associated liabilities	(498,913)	(520,103)
Fair value of associated derivatives	-	(5)
Net position	(2,939)	(4,463)

Transferred financial assets that are derecognized

During 2019, the Credit Union entered into a whole loan sale agreement with Central 1 to sell two pools of CMHC insured mortgages for $19,426 and $5,325. The Credit Union received net proceeds of $24,749 and recorded a loss of $2 (note 20) in other income. The Credit Union transferred all rights and obligations to the interest and principal from these mortgages and retains no prepayment, credit and interest rate risk. The Credit Union continues to service these mortgages and remit any associated net cash flow to Central 1. There were no whole loan sales during 2016, 2017 or 2018. The Credit Union received $50 (2018 – $31) in servicing revenues that was recorded in other income. Cumulatively, as of December 31, 2019, the Credit Union has received $306 in servicing revenues from the continuing involvement in these assets (2018 – $238). The Credit Union has determined that its maximum exposure to loss from its continuing involvement in these loans would be the lost servicing revenue of $46 (2018 – $12). The following tables describe the ending outstanding balances of the mortgages to be collected by the Credit Union on behalf of Central 1:

2019

	Maturity of continuing involvement						
	Total $	**Within 3 months** $	**3-6 months** $	**6 months – 1 year** $	**1-3 years** $	**3-5 years** $	**More than 5 years** $
Securitized loans	20,346	1,748	94	-	-	18,504	-

(expressed in thousands of dollars)

2018

					Maturity of continuing involvement		
	Total $	Within 3 months $	3-6 months $	6 months – 1 year $	1-3 years $	3-5 years $	More than 5 years $
Securitized loans	11,188	-	2,443	8,745	-	-	-

9 Investments

(expressed in thousands of dollars except for number of shares and value per share)

	2019 $	2018 $
Central 1 equity shares	16,184	15,894
Government backed securities	5,318	6,541
Government backed securities – reinvestment account (note 13)	145,026	131,028
Other investments	6,306	6,250
	172,834	159,713
Current portion	56,393	47,892
Non-current portion	116,441	111,821

Included in Central 1 equity shares are 63,324 (2018 – 63,324) Class E Central 1 shares issued with a paid up capital value of $0.01 each, redeemable at $100 each at the option of Central 1. In December 2017, Central 1 confirmed the intention to redeem 21,052 of Class E shares in the first quarter of 2018. Based on this information, the Credit Union recorded the 21,052 shares at the expected redemption value of $100 which resulted in an unrealized gain recognized in other reserves of $2,105. In 2018, Central 1 followed through on its intention to redeems these shares. Under transition to IFRS 9, these shares were designated as FVOCI which is not recyclable into net income; therefore they were transferred within equity from other reserves into retained earnings. In the same transaction as the redemption of the Class E shares, Central 1 also performed a restructuring which included a partial redemption of 10,514 Class A shares and a new Class F share issuance of 14,258 shares. The new Class F shares have a par value of $100 per share and are held at FVOCI. All classes of Central 1 shares are held at fair value, and it has been determined that cost approximates the fair value.

	2019 $	2018 $
Central 1 A shares	1,369	1,385
Central 1 F shares	14,814	14,508
Central 1 E shares at cost	1	1
Total Central 1 equity shares	16,184	15,894

(expressed in thousands of dollars)

10 Other assets

	2019 $	2018 $
Prepaid expenses	4,610	4,473
Accounts receivable	2,561	2,665
	7,171	7,138
Current portion	4,104	4,399
Non-current portion	3,067	2,739

11 Property, premises and equipment

	Equipment $	Leasehold improvements $	Land & Building $	Right-of-use assets $	Automotive equipment $	Total $
Cost						
As at December 31, 2017	14,310	11,188	1,411	-	40	26,949
Additions	1,160	620	18	-	-	1,798
Disposals	(1,172)	-	(9)	-	-	(1,181)
As at December 31, 2018	14,298	11,808	1,420	-	40	27,566
IFRS 16 – January 1, 2019	-	-	-	13,425	-	13,425
Additions	334	222	-	5,336	-	5,892
Disposals	(511)	(5)	-	-	-	(516)
As at December 31, 2019	14,121	12,025	1,420	18,761	40	46,367
Depreciation and impairment						
As at December 31, 2017	9,143	9,526	136	-	10	18,815
Disposals	(1,167)	-	(3)	-	-	(1,170)
Depreciation charge for the year	1,376	357	44	-	4	1,781
As at December 31, 2018	9,352	9,883	177	-	14	19,426
Disposals	(509)	(5)	-	-	-	(514)
Depreciation charge for the year	1,391	426	44	3,557	4	5,422
As at December 31, 2019	10,234	10,304	221	3,557	18	24,334
Carrying amounts						
As at December 31, 2018	4,946	1,925	1,243	-	26	8,140
As at December 31, 2019	3,887	1,721	1,199	15,204	22	22,033

Depreciation for Right of Use Assets was represented within occupancy costs within the consolidated statement of income and comprehensive income in prior years.

(expressed in thousands of dollars)

12 Intangibles

	Software $
Cost	
As at December 31, 2017	10,324
Additions	133
Disposals	(6)
As at December 31, 2018	10,451
Additions	257
As at December 31, 2019	10,708
Amortization	
As at December 31, 2017	8,824
Disposals	(6)
Amortization charge for the year	589
As at December 31, 2018	9,407
Amortization charge for the year	549
As at December 31, 2019	9,956
Carrying amounts	
As at December 31, 2018	1,044
As at December 31, 2019	752

Remaining amortization of the carrying amounts as at December 31, 2019 is as follows:

	$
Within 1 year	418
1 – 5 years	334
	752

13 Borrowings

	2019 $	2018 $
Subordinated debt	15,000	15,000
Lines of credit	54,998	44,891
Secured borrowings		
At amortized cost	506,286	473,146
At fair value	-	48,468
	576,284	581,505

(expressed in thousands of dollars)

Maturity date	Weighted average interest rate %	2019 $	2018 $
Due in 2019	-	-	106,477
Due in 2020	1.94	105,044	53,056
Due in 2021	1.40	256,982	253,403
Due in 2022	2.20	87,772	89,014
Due in 2023	2.26	81,843	64,555
Due in 2024	1.80	29,643	-
Due in 2027	6.89	15,000	15,000
		576,284	581,505
Current		105,044	106,477
Non-current		471,240	475,028

On June 27, 2017, the Credit Union entered into a subordinated debt agreement with Desjardins. This subordinated debt has an original term to maturity of 10 years and matures in June 26, 2027 with a right to repay after five years at the Credit Union's option. The subordinated debt qualifies as Tier 2 secondary capital for regulatory capital purposes. The interest rate is reset each quarter and is based on current cost of funds plus a fixed 4.85% spread. As at December 31, 2019, the total interest rate was 6.89% (2018 – 7.15%).

On January 9, 2020, the Credit Union exercised the available option following amalgamation on January 1, 2020 (note 30) to prepay and satisfy in full all debts, liabilities, and obligations owing under the subordinated debt agreement with Desjardins.

As of December 31, 2019, the Credit Union has approved lines of credit totalling $270,592 (2018 – $270,725).

Security provided as collateral for the line of credit facilities comprises a general and specific assignment of loans, accounts receivable, and a demand debenture in favour of Central 1. The Credit Union's borrowings are subject to certain covenants. As at December 31, 2019 and December 31, 2018, the Credit Union was in compliance with all covenants on its borrowings.

The secured borrowings arise from securitization transactions and are secured by specific pools of loans of $356,207 (2018 – $384,818) and government backed securities of $145,026 (2018 – $131,028) (notes 8 and 9).

14 Lease liabilities

The Credit Union leases various offices and branch locations. Rental contracts are typically made for fixed periods of five to 20 years, and can include extension options.

Contracts contain only lease and non-lease components. The Credit Union allocates the consideration in the contract to the lease and non-lease components based on their relative stand-alone prices.

(expressed in thousands of dollars)

Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. The lease agreements do not impose any covenants other than the security interests in the leased assets that are held by the lessor. Leased assets may not be used as security for borrowing purposes.

Prior to January 1, 2019, leases of property were classified as operating leases. From January 1, 2019, leases are recognized under IFRS 16 as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the Credit Union.

Extension and termination options are included in a number of property leases across the Credit Union. These are used to maximize operational flexibility in terms of managing the assets used in the Credit Union's operations. The majority of extension and termination options held are exercisable only by the Credit Union and not by the respective lessor.

			2019	January 1, 2019
	Future minimum lease payments $	Interest $	Present value of minimum lease payments $	Present value of minimum lease payments $
Less than one year	3,701	(487)	3,214	3,323
Between one and five years	10,951	(969)	9,982	8,835
More than five years	2,311	(139)	2,172	1,267
Balance at December 31, 2019	16,963	(1,595)	15,368	13,425

Additions to the lease liabilities during the 2019 financial year were $5,336.

15 Deposits

	2019 $	2018 $
Term deposits	1,749,463	1,746,573
Demand deposits	826,481	817,624
Registered savings plans	498,992	471,930
Member deposit shares (note 16(b))	3,049	3,827
Deferred transaction costs	(232)	(231)
Accrued interest	24,779	20,926
	3,102,532	3,060,649
Current	2,556,120	2,451,382
Non-current	546,412	609,267

(expressed in thousands of dollars)

16 Deposit and members' equity shares

a) Authorized shares
(expressed in thousands of dollars except for value per share)

Unlimited number of shares with a par value and redemption value of $1 each:
Class A Membership voting equity shares
Class B Patronage voting equity shares
Class C Investment non-voting equity shares
Class D Insured Non-equity shares

Unlimited number of Class E Equity voting, non-redeemable, non-cumulative shares with a par value of $1 each

Unlimited number of Class F, G, H and I Preferred shares. Each class of Preferred share is issuable in Series (Series 1, 2 or 3). Each Series of each class can be offered in 3-, 5-, 7- or 10-year terms. Each class of Preferred share is redeemable at the end of its term, non-voting and entitled to cumulative dividends at a rate set when issued.

b) Issued shares classified as deposits (note 15) consist of the following:
(expressed in thousands of dollars except for number of shares)

	2019 $	2018 $
3,049,030 (2018 – 3,827,235) Class A Membership equity shares	3,049	3,827
Class A Membership equity shares issued in the year	208	204
Class A Membership equity shares redeemed in the year	(986)	(255)
Net redemptions in the year	(778)	(51)

c) Issued shares classified as members' equity consist of the following:
(expressed in thousands of dollars except for number of shares)

	2019 $	2018 $
Nil (2018 – 3,058,878) Class C Investment equity shares	-	3,059

The Class C Investment equity shares were subject to full redemption in 2019. No new Class C Investment equity shares were issued during the year (2018 – nil).

(expressed in thousands of dollars)

17 Pension and other retirement benefits

The Credit Union provides pension benefits to employees through defined contribution, defined benefit, supplemental retirement and multi-employer defined benefit plans. Other post-retirement benefits including health care, dental benefits or cash alternatives are provided to eligible Credit Union employees upon or after retirement.

The defined benefit plans are registered in the Province of British Columbia and governed by provincial regulations and practices. They are administered by a Board of Trustees.

The Credit Union operates four defined benefit plans in Canada, two of which are funded plans and two are unfunded plans. The risk characteristics and assumptions are similar for all defined benefit plans. The Credit Union funds the defined benefit plans and multi-employer defined benefit plans based on actuarially prescribed amounts. The unfunded supplemental retirement and non-pension post-retirement benefits are paid by the Credit Union at the time of entitlement. The weighted average duration of the defined benefit obligation is as follows:

			2019	2018
	Funded plans	Unfunded plans		
Weighted average duration	17 years	7 years	17 years	17 years

The unfunded portion of the defined benefit obligation is $1,449 (2018 – $1,680). The accrued benefit obligation for the supplemental retirement plan is secured by an irrevocable letter of credit issued by the Credit Union in the amount of $893 (2018 – $991).

(expressed in thousands of dollars)

a) Retirement benefit obligation

	2019			2018
	Funded plans $	**Unfunded plans $**	**Total $**	**Total $**
Defined benefit obligation	(32,352)	(1,511)	(33,863)	(31,406)
Fair value of plan assets	27,578	62	27,640	24,419
Net retirement benefit obligation	(4,774)	(1,449)	(6,223)	(6,987)
Retirement benefit asset recognized on the consolidated statement of financial position	650	-	650	539
Retirement benefit obligation recognized on the consolidated statement of financial position	(5,424)	(1,449)	(6,873)	(7,526)
Net retirement benefit obligation	(4,774)	(1,449)	(6,223)	(6,987)
Current portion			(1,470)	(1,271)
Non-current portion			(4,753)	(5,716)

The movement in the defined benefit obligation is as follows:

	2019			2018
	Funded plans $	**Unfunded plans $**	**Total $**	**Total $**
Defined benefit obligation at January 1	29,665	1,741	31,406	32,501
Current service cost (net of employee contributions)	757	33	790	836
Interest cost	1,126	63	1,189	1,139
Remeasurements – experience	(1,697)	(4)	(1,701)	266
Remeasurements – demographic	253	-	253	(73)
Remeasurements – financial	3,267	82	3,349	(1,439)
Benefit payments	(1,019)	(404)	(1,423)	(1,588)
Past service costs	-	-	-	(236)
Defined benefit obligation at December 31	32,352	1,511	33,863	31,406

(expressed in thousands of dollars)

b) Fair value of plan assets

i) Movement in the fair value of plan assets is as follows:

	2019			2018
	Funded plans $	**Unfunded plans $**	**Total $**	**Total $**
Fair value of plan assets at January 1	24,359	60	24,419	23,363
Interest income	919	-	919	812
Administration expenses	(48)	-	(48)	(71)
Remeasurements – financial	2,328	-	2,328	501
Employer contributions	1,039	406	1,445	1,402
Benefit payments	(1,019)	(404)	(1,423)	(1,588)
Fair value of plan assets at December 31	27,578	62	27,640	24,419

ii) Funded plan assets comprise the following:

	Funded defined benefit plans	
	2019 %	**2018 %**
Asset category		
Equity securities	48	46
Debt instruments	29	27
Real estate	13	14
Other assets	10	13
	100	100

In the table above, all asset classes aside from the cash portion representing 3% of the portfolio have quoted prices in active markets. The accrued benefit obligation and plan assets of all four defined benefit plans were actuarially measured for accounting purposes as of December 31, 2019. The effective date of the last actuarial valuation reports for funding purposes was December 31, 2018 and the effective date of the next required actuarial valuation report for funding purposes will be December 31, 2021.

(expressed in thousands of dollars)

The December 31, 2018 actuarial valuations for the funded plans indicated a going concern excess of $1,253 (2015 – unfunded liability of $788) and a solvency excess of $156 (2015 – solvency deficiency of $542). Deficits are targeted to be financed over time through increased contributions. The pension regulator has determined the period during which a solvency deficit must be funded. As approved by the regulator, the plan solvency deficit is expected to be funded by December 2026. The Credit Union paid $1,040 (2018 – $1,121) for employer contributions to the funded plans in fiscal year 2019. As a result of the valuation, the employer contribution rates were determined to be a combination of a flat dollar amount of $384 (2018 – $600) per annum effective January 1, 2020 to fund the solvency deficit in addition to a contribution to fund current service costs which is based on a percentage of pensionable earnings of the respective participating employees ranging from 8.1% – 15.8% per annum depending on the plan holder's age.

The investment policy relative to the majority of the funded plan assets reflects the Trustees' belief that the asset mix strategy should contain a combination of return enhancing and liability/duration matching investments to achieve the plan's investment return objectives and to protect the plan from significant fluctuations in the plan's solvency ratio.

The investment strategy of the Trustees of the plan is that the asset mix should contain a combination of return enhancing and liability/duration matching investments to achieve the plan's investment return objectives and to protect the plan from significant fluctuations in the plan's solvency ratio. The duration matching investments include investments in long bonds while the return enhancing investments include a diversification of investments in equities, real estate, and hedge funds.

The expected return on plan assets is determined by considering the expected returns available on the assets underlying the current investment policy. Expected yields on fixed interest investments are based on gross redemption yields as at the date of the consolidated statement of financial position. Expected returns on equity and property investments reflect long-term rates of return experienced in the respective markets. The actual return on plan assets for the year ended December 31, 2019 was $3,247 (2018 – $1,312).

c) Future contributions and benefit payments

The expected contributions and benefit payments for the year ending December 31, 2020 are as follows:

	$
Employer contributions	1,139
Employee benefits	(1,470)

(expressed in thousands of dollars)

d) The amounts recognized in the consolidated statement of income were as follows:

	2019 $	2018 $
Current service cost (net of employee contributions)	790	836
Interest cost	1,189	1,139
Administration costs	48	71
Past service cost	-	(236)
Interest income	(919)	(812)
Total included in employee benefits expense (note 21)	1,108	998

e) The amounts recognized in other comprehensive income (loss) were as follows:

	2019 $	2018 $
Remeasurements in the year	427	1,747
Income tax (recovery)	(73)	(297)
Other comprehensive income related to defined benefit plans for the year	354	1,450

f) The principal actuarial assumptions used, consistent for all defined benefit plans of the Credit Union, were as follows:

	2019 %	2018 %
Discount rate	3.13	3.82
Inflation rate	2.00	2.00
Future salary increases	3.00	3.00

The principal health care cost assumptions used in the post-retirement defined benefit plan were as follows:

	2019 %	2018 %
Health care cost		
Extended health	7.00	7.00
Dental	4.50	4.50

For plans or portion of plans where indexing is used, future pension increase assumptions are based on 50% of the inflation rate.

(expressed in thousands of dollars)

Actuarial assumptions are management's best estimate assumptions. Assumptions regarding future mortality are set based on actuarial advice in accordance with published statistics and experience. Mortality assumptions, consistently for all defined benefit plans of the Credit Union, are based on the 2014 Canadian Pensioners' Mortality (CPM) Table with 105% pension size adjustment factors and generational mortality improvements in accordance with the CPM Improvement Scale B. The projection factors are in accordance with the published table Scale AA where annual improvements range from 0.4% to 2% for males and 0.3% to 1.8% for females.

The tables translate the average post-retirement life expectancy of males to 22 years (2018 – 22 years) and females to 24 years (2018 – 24 years) for a pensioner retiring at age 65.

The sensitivity of the defined benefit obligation to changes in the weighted principal assumptions presented below was performed by changing each assumption individually. If an actual change occurs, it is likely that some of these assumptions are correlated, which could change the combined impact.

	2019 $	**2018** $
Discount rate		
Impact of: 1% increase	(4,887)	(4,753)
1% decrease	6,269	6,073
Inflation rate		
Impact of: 1% increase	1,558	1,470
1% decrease	(1,421)	(1,346)
Future salary increases		
Impact of: 1% increase	805	1,431
1% decrease	(701)	(1,218)
Medical/dental trends		
Impact of: 1% increase	85	76
1% decrease	(72)	(65)

g) Through its defined benefit plans, the Credit Union is exposed to a number of risks, the most significant of which are detailed below:

i) Investment risk

The defined benefit obligation is calculated with a discount rate. If the return on assets is lower than the discount rate, it will create a deficit.

ii) Interest rate risk

A variation in bond rates will affect the value of the defined benefit obligation.

(expressed in thousands of dollars)

iii) Longevity risk

A greater increase in life expectancy than the one predicted by the mortality table used will increase the defined benefit obligation.

iv) Inflation risk

The defined benefit obligation is calculated taking into account an increase in the level of salary and future cost of living adjustments. If actual inflation is greater than expected, that would result in an increase in the defined benefit obligation.

h) Participation in multi-employer plan

The Credit Union participates in a plan for certain eligible employees which is administered by Central 1.

The Credit Union is one of several employers that participate in the BC Credit Union Employees' Pension Plan (the Plan). The Plan is a multi-employer contributory defined benefit pension plan governed by a 12-member Board of Trustees. The Board of Trustees is responsible for overseeing the management of the Plan, including investment of the assets and administration of the benefits. The Plan, as at December 31, 2015, had about 3,200 active employees and approximately 760 retired plan members. Total plan assets at December 31, 2019 are estimated at $869,783 (2018 – $729,403). Every three years, an actuarial valuation is performed to assess the financial position of the Plan and the adequacy of the funding level. The most recent actuarial valuation, which was conducted as at December 31, 2018, indicated a going concern excess of $31,575 and a solvency deficiency of $22,579. The deficit is targeted to be financed over time through increased contributions, collectively, from the participating employers. The pension regulator has determined the period during which the solvency deficit must be funded. As approved by the regulator, the plan solvency deficit is expected to be funded by December 2026. The Credit Union paid $2,487 (2018 – $2,557) for employer contributions to the Plan in fiscal year 2019. Retirement benefits for the Plan are paid by the Credit Union monthly. As a result of the valuation, the contribution rates were determined to be 14.8% per annum for employer contributions based on the pensionable earnings of the respective participating employees and 2% to 10% per annum, depending on the plan holder's age, for employee contributions effective January 1, 2020. The contributions continue to be expensed as invoiced by the Plan. The next actuarial valuation is scheduled for December 31, 2021.

18 Other liabilities

	2019 $	2018 $
Accounts payable and accruals	9,971	6,302
Deferred revenue	33	44
	10,004	6,346
Current	9,878	6,208
Non-current	126	138

(expressed in thousands of dollars)

19 Net interest income

	2019 $	2018 $
Interest income and dividend income		
Financial instruments measured at amortized cost using the effective interest method		
Cash and cash equivalents	122	151
Interest bearing deposits	7,195	5,951
Investments	2,862	2,046
Loans and receivables	114,265	102,672
Financial instruments measured at FVTPL		
Loans and receivables	8,383	11,531
Derivatives	284	82
Financial instruments measured at FVOCI using the effective interest method		
Investments	269	238
Cash flow hedges	(999)	(143)
	132,381	122,528
Interest expense		
Financial instruments measured at amortized cost		
Deposits	58,311	44,517
Borrowings		
Lines of credit	1,104	2,507
Subordinated debt	1,052	1,007
Secured borrowings	7,817	6,303
Lease obligation	432	-
Financial instruments measured at FVTPL		
Secured borrowings	412	1,141
	69,128	55,475
Net interest income	63,253	67,053

(expressed in thousands of dollars)

20 Other income

	2019 $	2018 $
Investment management	5,865	6,389
Service charges	4,967	4,948
Insurance commissions	581	859
Loan fees	890	712
Foreign exchange	526	639
Contract renewal fee	-	500
Other	60	163
Recoveries on loans measured at fair value	729	-
Loss on change in fair value measurement (note 7)	(6,505)	(15,381)
	7,113	(1,171)

21 Salaries and employee benefits

	2019 $	2018 $
Salaries	32,033	25,915
Benefits		
Other	3,818	3,103
Post-employment defined benefit plans	38	(237)
Pension costs		
Defined contribution plans including multi-employer plan	2,553	2,638
Defined benefit plans	1,070	1,235
	39,512	32,654

22 Other expenses

	2019 $	2018 $
Deposit insurance fees	2,982	2,714
Loan administration fees	1,536	1,753
Professional services	1,364	1,299
Other	424	501
Central 1 dues	345	377
Loss on sale of property, premises and equipment	1	42
	6,652	6,686

(expressed in thousands of dollars)

23 Income taxes

	2019 $	2018 $
Current tax expense	337	521
Deferred tax expense	(399)	(76)
	(62)	445

Reconciliation of effective tax rate

Deferred taxes are calculated on all temporary differences under the liability method using an effective tax rate. The income tax expense differs from the amount that would be computed by applying the combined federal and provincial statutory income tax rate of 27% (2018 – of 27%) to income before income taxes. The reasons for the differences are as follows:

	2019 $	2018 $
Computed tax (recovery) expense	(286)	543
Increase (decrease) resulting from		
Preferred rate amount deduction for credit unions	106	(201)
Non-taxable items	31	33
Effect of tax rate changes on deferred income tax asset	-	(1)
Other	87	71
	(62)	445

The effective tax rate for the Credit Union, net of the credit union deduction was 17.00% (2018 – 17.00%). The overall tax rate was 5.48% (2018 – 22.97%). The rates reflect adjustments to the prior year tax return and provision adjustments due to more accurate information available at the time of filing the return.

Deferred income tax assets and liabilities are as follows:

	2019 $	2018 $
Deferred income tax assets		
To be recovered within 12 months	981	408
To be recovered after more than 12 months	2,311	2,447
	3,292	2,855
Deferred income tax liabilities		
To be settled within 12 months	220	1
To be settled after more than 12 months	418	287
	638	288
Net deferred income tax assets	2,654	2,567

(expressed in thousands of dollars)

The movement in deferred tax assets and liabilities is as follows:

	December 31, 2018 $	Recognized in profit or loss $	Recognized in other comprehensive income $	December 31, 2019 $
Deferred income tax assets				
Provision for credit losses	714	(97)	-	617
Deferred revenue	340	168	-	508
Retirement benefit obligation and severance accruals	1,187	28	(73)	1,142
Property, premises, equipment and software intangibles – differences between carrying amounts and undepreciated capital cost	529	(152)	-	377
Loss carry-forwards	85	-	-	85
Other	-	802	(239)	563
	2,855	749	(312)	3,292
Deferred income tax liabilities				
Prepaid loan expenses	857	(266)	-	591
Other	(569)	616	-	47
	288	350	-	638
Net deferred income tax assets	2,567	399	(312)	2,654

(expressed in thousands of dollars)

	December 31, 2017 $	Recognized in profit or loss $	Recognized in other comprehensive income $	December 31, 2018 $
Deferred income tax assets				
Provision for credit losses	489	225	-	714
Deferred revenue	436	(96)	-	340
Retirement benefit obligation and severance accruals	1,552	(68)	(297)	1,187
Property, premises, equipment and software intangibles – differences between carrying amounts and undepreciated capital cost	294	235	-	529
Loss carry-forwards	85	-	-	85
Other	18	(18)	-	-
	2,874	278	(297)	2,855
Deferred income tax liabilities				
Prepaid loan expenses	941	(84)	-	857
Other	(300)	286	(555)	(569)
	641	202	(555)	288
Net deferred income tax assets	2,233	76	258	2,567

24 Commitments and contingent liabilities

Commitments

a) Letters of credit and other guarantees

In the normal course of business, the Credit Union has outstanding letters of credit issued on behalf of members totalling $18,797 (2018 – $15,803), which are secured by term deposits or property mortgages.

b) Undrawn loan commitments

Refer to note 25.

Contingent liabilities

In the course of its business, various claims and legal proceedings may arise against the Credit Union. The Credit Union defends itself where appropriate and is currently of the opinion that it is likely to prevail; accordingly, no provision has been made in these consolidated financial statements.

(expressed in thousands of dollars)

25 Risk management

The Credit Union's risk management framework is designed to ensure that the outcomes of risk-taking activities are consistent with its strategies and risk appetite, and that there is an appropriate balance between risk and reward in order to maximize the Credit Union's returns. Risk management is carried out by a number of delegated committees reporting to the Board. The Board has overall responsibility for the establishment and oversight of the Credit Union's risk management framework. In addition, the Credit Union maintains an internal audit function, which is responsible for independent review of risk management and the Credit Union's control environment.

The risk management framework is subject to constant evaluation to ensure that it meets the challenges and requirements of the markets in which the Credit Union operates, including regulatory standards and industry best practices.

The Credit Union's risk management framework is applied on an enterprise-wide basis and consists of three key elements:

a) Risk governance – a set of tools, policies and processes that the Credit Union has in place to identify, measure and manage its risks;

b) Risk appetite – outlines the amount and type of risk the Credit Union is willing to accept in order to pursue its strategic plan, providing an overview of the Credit Union's tolerance for risk which defines the boundaries within which risk-based decision-making can occur;

c) Risk management techniques – as guided by the Credit Union's risk appetite framework are integrated with the Credit Union's strategies and business planning process and include the following:

    i) Strategies, policies and limits

    ii) Guidelines, process and standards

    iii) Measurement, monitoring and reporting

Financial instruments comprise the majority of the Credit Union's assets and liabilities. The Credit Union accepts deposits at both fixed and floating rates for various periods and seeks to earn an interest rate margin by investing these funds in high quality financial instruments – principally mortgages. The primary types of financial risks that arise from these activities are credit, liquidity and market risk in the form of interest rate risk.

d) Credit risk

Credit risk is the risk of loss resulting from the failure of a borrower or counterparty to honour its financial and contractual obligations to the Credit Union. Credit risk arises in the Credit Union's direct lending operations, funding and investment activities where counterparties have repayment or other obligations to the Credit Union.

(expressed in thousands of dollars)

The measurement of ECL under IFRS 9 uses the information and approaches that the Credit Union uses to manage credit risk, though certain adjustments are made in order to comply with the requirements of IFRS 9. The approach taken for IFRS 9 measurement purposes is discussed below.

i) Management of credit risk

The effective management of credit risk requires the establishment of an appropriate credit risk culture. Key credit risk policies and credit risk management strategies are important elements used to create this culture. The Board of Directors, both directly and through executive and board committees, reviews and approves the Credit Union's credit risk strategy and credit risk policy on an annual basis. The objectives of the credit risk strategy are to ensure that:

- Target markets and product offerings are well defined at both the organizational and lines of business levels;
- The risk parameters for new underwritings and for the portfolios as a whole are clearly specified; and
- Transactions, including origination, syndication, loan sales and hedging, are managed in a manner that is consistent with the Credit Union's risk appetite.

The credit risk policy articulates the credit risk management framework, including:

- Key credit risk management principles;
- Delegation of authority;
- The credit risk management program;
- Aggregate limits, beyond which credit applications must be escalated to the Board for approval; and
- Single name/aggregation exposures, beyond which exposures must be reported to the Board.

Management develops the credit risk management framework and policies that detail, among other things, the credit risk rating systems and associated parameter estimates; the delegation of authority for granting credit; the calculation of the allowance for credit losses; and the authorization of write-offs.

The Credit Union regularly reviews the various segments of the credit portfolio on an enterprise-wide basis to assess the impact of economic trends or specific events on the performance of the portfolio, and to determine whether corrective action is required. These reviews include the examination of the risk factors for particular products and industries. The results of these reviews are reported to the senior management and, when significant, to the Board.

Concentration of loans is managed by the implementation of sectoral and member specific limits as well as the periodic use of syndications with other financial institutions to limit the potential exposure to any one member.

(expressed in thousands of dollars)

The Credit Union has developed models to support the quantification of the credit risk. These rating and scoring models are in use for all key credit portfolios and form the basis for measuring default risks. In measuring credit risk of loan and advances at a counterparty level, the Credit Union considers three components: (i) the "probability of default" by the client or counterparty on its contractual obligations; (ii) current exposures to the counterparty and its likely future development, from which the Credit Union derives the "exposure at default"; and (iii) the likely recovery ratio on the defaulted obligations (the loss given default). The models are reviewed regularly to monitor their robustness relative to actual performance and amended as necessary to optimize their effectiveness.

ii) ECL measurement

IFRS 9 outlines a 'three-stage' model for impairment based on changes in credit quality since initial recognition as summarized below:

- A financial instrument that is not credit-impaired on initial recognition is classified in 'Stage 1' and has its credit risk continuously monitored by the Credit Union.
- If a SICR since initial recognition is identified, the financial instrument is moved to 'Stage 2' but is not yet deemed to be credit-impaired.
- If the financial instrument is credit-impaired, the financial instrument is then moved to 'Stage 3'.
- Financial instruments in Stage 1 have their ECL measured at an amount equal to the portion of lifetime expected credit losses that result from default events possible within the next 12 months. Instruments in Stage 2 or Stage 3 have their ECL measured based on expected credit losses on a lifetime basis.
- A pervasive concept in measuring ECL in accordance with IFRS 9 is that it should consider forward-looking information.
- Purchased or originated credit-impaired financial assets are those financial assets that are credit-impaired on initial recognition. Their ECL is always measured on a lifetime basis (Stage 3).

The following diagram summarizes the impairment requirements under IFRS 9 (other than purchased or originated credit-impaired financial assets):

Stage 1 (Initial recognition)	**Stage 2 (Significant increase in credit risk since intial recognition)**	**Stage 3 (Credit impaired assets)**
12-month expected credit losses	Lifetime expected credit losses	Lifetime expected credit losses

(expressed in thousands of dollars)

The key judgments and assumptions adopted by the Credit Union in addressing the requirements of the standard are discussed below:

Significant increase in credit risk (SICR)

The Credit Union considers a financial instrument to have experienced a significant increase in credit risk when one or more of the following quantitative, qualitative or backstop criteria have been met:

i) For personal banking

Beacon scores that are available in the banking system are queried and updated on a annual basis and reviewed for deterioration. Management has determined thresholds for credit score changes that indicate a SICR:

- a 200 point change of any scores above 650;
- a 100 point change of any scores between 650 and 510;
- a 50 point change of any scores below 650.

Any personal banking loan that is currently or has been in the past six months more than 30 days past due.

Any personal banking loan that is currently monitered as a result of a requirement to pay and/or family maintenance claim.

ii) For business banking

- Any Commercial loan with a Risk Rating of 7-10.
- Any Commercial loan on the Watch list or Out of Order report.
- Any Commercial loan that is currently or has been in the past six months more than 30 days past due.
- Any Commercial loan that is currently monitered as a result of a requirement to pay and/or family maintenance claim.

(expressed in thousands of dollars)

The assessment of SICR incorporates forward-looking information and is performed on a quarterly basis at a portfolio level for all instruments held by the Credit Union. Management applies a secondary review of outputs from all methods and criteria used to identify SICR to ensure resulting assessments are inclusive of any required adjustments to accomodate management judgment in such determinations. This ensures that any anomalies produced through strict data extrapolations and modeling are adjusted through a secondary review. A Watchlist is used to monitor credit risks, this assessment is performed at the counterparty level and on a periodic basis. The criteria used to identify SICR are monitored and reviewed periodically for appropriateness by the Finance department.

iii) Backstop

A backstop is applied and the financial instrument is considered to have experienced a significant increase in credit risk if the borrower is more than 30 days past due on its contractual payments.

The Credit Union has not used the low credit risk exemption for any financial instruments in the years ended December 31, 2019 or 2018.

Definition of default and credit-impaired assets

The Credit Union defines a financial instrument as in default, which is fully aligned with the definition of credit impaired, when it meets one or more of the following:

Quantitative criteria

The borrower is more than 90 days past due on its contractual payments.

Qualitative criteria

The borrower meets unlikeliness to pay criteria, which indicates the borrower is in significant financial difficulty. These are instances where:

- The borrower is in long-term forbearance.
- The borrower is deceased.
- The borrower is insolvent.
- The borrower is in breach of financial covenant(s).
- An active market for that financial asset has disappeared because of financial difficulties.
- Concessions have been made by the lender relating to the borrower’s financial difficulty.
- It is becoming probable that the borrower will enter bankruptcy.
- Financial assets are purchased or originated at a deep discount that reflects the incurred credit losses.

(expressed in thousands of dollars)

The criteria above have been applied to all financial instruments held by the Credit Union and are consistent with the definition of default used for internal credit risk management purposes. The default definition has been applied consistently to model the Probability of Default (PD), Exposure at Default (EAD) and Loss given Default (LGD) throughout the Credit Union's expected loss calculations.

An instrument is considered to no longer be in default (i.e. to have cured) when it no longer meets any of the default criteria for a consecutive period of six months. This period of six months has been determined based on an analysis which considers the likelihood of a financial instrument returning to default status after cure using different possible cure definitions.

Measuring ECL — Explanation of inputs, assumptions and estimation techniques

The ECL is measured on either a 12-month (12M) or Lifetime basis depending on whether a significant increase in credit risk has occurred since initial recognition or whether an asset is considered to be credit-impaired. ECLs are the discounted product of the PD, EAD, and LGD, defined as follows:

i) The PD represents the likelihood of a borrower defaulting on its financial obligation, either over the next 12 months (12M PD), or over the remaining lifetime (Lifetime PD) of the obligation.

ii) EAD is based on the amounts the Credit Union expects to be owed at the time of default, over the next 12 months (12M EAD) or over the remaining lifetime (Lifetime EAD). For example, for a revolving commitment, the Credit Union includes the current drawn balance plus any further amount that is expected to be drawn up to the current contractual limit by the time of default, should it occur.

iii) Loss Given Default (LGD) represents the Credit Union's expectation of the extent of loss on a defaulted exposure. LGD varies by collective segment and the year of origination. LGD is expressed as a percentage loss per unit of exposure at the time of default (EAD). LGD is calculated on a 12-month or lifetime basis, where 12-month LGD is the percentage of loss expected to be made if the default occurs in the next 12 months and Lifetime LGD is the percentage of loss expected to be made if the default occurs over the remaining expected lifetime of the loan.

The ECL is determined by projecting the PD, LGD and EAD for each future month and for each collective segment. These three components are multiplied together, which effectively calculates an ECL for each future month.

The Lifetime PD is developed by applying a maturity profile to the current 12M PD. The maturity profile looks at how defaults develop on a portfolio from the point of initial recognition throughout the lifetime of the loans. The maturity profile is based on historical observed data and is assumed to be the same across all assets within a portfolio and credit grade band. This is supported by historical analysis.

(expressed in thousands of dollars)

The 12-month and lifetime EADs are determined based on the expected payment profile, which varies by product type.

i) For amortizing products, this is based on the contractual repayments owed by the borrower over a 12 month or lifetime basis.

ii) For revolving products, the exposure at default is predicted by taking current drawn balance and adding a “credit conversion factor” which allows for the expected drawdown of the remaining limit by the time of default. These assumptions vary by product type and current limit utilization band, based on analysis of the Credit Union’s recent default data.

The 12-month and lifetime LGDs are determined based on the factors which impact the recoveries made post default. These vary by product type.

Forward-looking economic information is also included in determining the 12-month and lifetime PD, EAD and LGD. These assumptions vary by product type. Forecasts of macroeconomic indicators such as interest rates, unemployment rates and vacancy rates as well as expectations of changes in the housing market all affect the ECL calculation. Each product is evaluated separately based on the expected impact of the economic factor and is assigned its own forward-looking weighting.

The assumptions underlying the ECL calculation, such as how the maturity profile of the PDs change etc., are monitored and reviewed on a annual basis.

The following tables explain the changes in the loss allowance between the beginning and the end of the annual period due to these factors:

Personal banking	Stage 1 12-month ECL $	Stage 2 Lifetime ECL $	Stage 3 Lifetime ECL $	Total $
Loss allowance as at December 31, 2018	632	1,173	60	1,865
Transfers				
Transfer from Stage 1	(6)	3	3	-
Transfer from Stage 2	1,033	(1,049)	16	-
Transfer from Stage 3	-	-	-	-
Movements with P&L impact				
New financial assets originated	92	92	49	233
Changes in PDs/LGDs/EADs	(1,097)	450	658	11
Remeasurements	29	401	(526)	(96)
Financial assets derecognized during the period	(78)	(227)	-	(305)
Write-offs	-	-	(69)	(69)
Loss allowance as at December 31, 2019	605	843	191	1,639

(expressed in thousands of dollars)

Business banking	Stage 1 12-month ECL $	Stage 2 Lifetime ECL $	Stage 3 Lifetime ECL $	Total $
Loss allowance as at December 31, 2018	1,087	1,239	643	2,969
Transfers				
Transfer from Stage 1	(7)	6	1	-
Transfer from Stage 2	918	(924)	6	-
Transfer from Stage 3	-	-	-	-
Movements with P&L impact				
New financial assets originated	309	518	208	1,035
Changes in PDs/LGDs/EADs	(842)	374	(5)	(473)
Remeasurements	(156)	(67)	707	484
Financial assets derecognized during the period	(271)	(162)	-	(433)
Write-offs	-	-	(138)	(138)
Loss allowance as at December 31, 2019	1,038	984	1,422	3,444

The principal assumptions used in the calculation of the ECLs were the PD and LGDs. These assumptions are shown in the tables below:

Personal banking – December 31, 2019	Stage 1 12-month PD %	Stage 2 Lifetime PD %	Stage 3 Lifetime PD %
Residential mortgages (insured and uninsured)	0.35	51.00	100.00
Equity lines of credit	0.20	51.00	100.00
Loans	0.55	51.00	100.00
Lines of credit	0.35	61.00	100.00
Business banking – December 31, 2019			
Mortgages	1.85	51.00	100.00
Loans	0.75	51.00	100.00
Lines of credit	1.00	61.00	100.00

(expressed in thousands of dollars)

Personal banking – December 31, 2018	**Stage 1 12-month PD %**	**Stage 2 Lifetime PD %**	**Stage 3 Lifetime PD %**
Residential mortgages (insured and uninsured)	0.35	53.00	100.00
Equity lines of credit	0.20	53.00	100.00
Loans	0.56	53.00	100.00
Lines of credit	0.35	66.00	100.00
Business banking – December 31, 2018			
Mortgages	1.40	53.00	100.00
Loans	0.75	53.00	100.00
Lines of credit	0.75	66.00	100.00

Personal banking – December 31, 2019	**Stage 1 12-month LGD %**	**Stage 2 Lifetime LGD %**	**Stage 3 Lifetime LGD %**
Residential mortgages (insured)	0.74	0.74	0.74
Residential mortgages (uninsured)	1.64	1.64	1.64
Equity lines of credit	1.64	1.64	1.64
Loans	85.00	85.00	85.00
Lines of credit	100.00	100.00	100.00
Business banking – December 31, 2019			
Mortgages	0.65	0.65	0.65
Loans	100.00	100.00	100.00
Lines of credit	100.00	100.00	100.00

Personal banking – December 31, 2018	**Stage 1 12-month LGD %**	**Stage 2 Lifetime LGD %**	**Stage 3 Lifetime LGD %**
Residential mortgages (insured)	0.97	0.97	0.97
Residential mortgages (uninsured)	0.71	0.71	0.71
Equity lines of credit	0.71	0.71	0.71
Loans	100.00	100.00	100.00
Lines of credit	100.00	100.00	100.00
Business banking – December 31, 2018			
Mortgages	1.55	1.55	1.55
Loans	100.00	100.00	100.00
Lines of credit	100.00	100.00	100.00

(expressed in thousands of dollars)

The sensitivity of the ECL to changes in the principal assumptions was performed by changing each assumption individually. If an actual change occurs, it is likely that some of these assumptions are correlated, which could change the combined impact. The sensitivity of the principal assumptions above are shown in the table below:

		December 31, 2019 $	December 31, 2018 $
Personal banking – PD sensitivity			
Impact of:	1% increase	1,706	1,726
	1% decrease	(1,706)	(1,726)
Business banking – PD sensitivity			
Impact of:	1% increase	1,096	1,374
	1% decrease	(1,096)	(1,374)
Personal banking – LGD sensitivity			
Impact of:	1% increase	220	299
	1% decrease	(220)	(299)
Business banking – LGD sensitivity			
Impact of:	1% increase	225	244
	1% decrease	(225)	(244)

The sensitivity of a 1% increase or decrease to the PD assumptions for the total Personal banking portfolio is +/- $1,706 (2018 – $1,726), with the highest sensitivity being in the personal line of credit segment of +/- $1,260 (2018 +/- $1,320).

The sensitivity of a 1% increase or decrease to the PD assumptions for the total Business banking portfolio is +/- $1,096 (2018 +/- $1,374), with the highest sensitivity being in the commercial line of credit segment of +/- $723 (2018 +/- $840).

Grouping of instruments for losses measured on a collective basis

For ECL provisions modelled on a collective basis, a grouping of exposures is performed on the basis of shared risk characteristics, such that risk exposures within a group are homogeneous.

In performing this grouping, there must be sufficient information for the group to be statistically credible. Where sufficient information is not available internally, the Credit Union has considered benchmarking internal/external supplementary data to use for modelling purposes. The characteristics and any supplementary data used to determine groupings are outlined below:

(expressed in thousands of dollars)

Groupings for collective measurement

i) The nature of the borrower

ii) Collateral type

iii) Credit rating band

The credit exposures in Stage 3 are assessed individually. The appropriateness of groupings is monitored and reviewed on a periodic basis by the credit team.

i) Credit risk exposure

Collateral and other credit enhancements

The Credit Union employs a range of policies and practices to mitigate credit risk. The most common of these is accepting collateral for funds advanced. The Credit Union has internal policies on the acceptability of specific classes of collateral or credit risk mitigation.

The Credit Union prepares a valuation of the collateral obtained as part of the loan origination process. This assessment is reviewed periodically. The principal collateral types for loans and advances are:

- Mortgages over residential properties;
- Charges over business assets such as premises, inventory and accounts receivable; and
- Charges over financial instruments such as debt securities and equities.

Longer-term finance and lending to corporate entities are generally secured; revolving individual credit facilities are generally unsecured.

The Credit Union's policies regarding obtaining collateral have not significantly changed during the reporting period and there has been no significant change in the overall quality of the collateral held by the Credit Union since the prior period.

Valuations of collateral are updated periodically depending on the nature of the collateral. The Credit Union has policies in place to monitor the existence of undesirable concentration in the collateral supporting its credit exposure.

(expressed in thousands of dollars)

The Credit Union closely monitors collateral held for financial assets considered to be credit-impaired, as it becomes more likely that the Credit Union will take possession of collateral to mitigate potential credit losses. Financial assets that are credit-impaired and related collateral held in order to mitigate potential losses are shown below. The carrying amount approximates the gross exposure at default (EAD) on these loans without considering collateral except where a specific provision has been assessed to include costs to collect.

	2019	
	Carrying amount $	Impairment allowance $
Credit impaired assets		
Personal banking loans measured at amortized cost	2,171	191
Business banking	10,447	1,422
Total credit-impaired assets	12,618	1,613

	2018	
	Carrying amount $	Impairment allowance $
Credit impaired assets		
Personal banking loans measured at amortized cost	1,326	60
Business banking	6,033	643
Total credit-impaired assets	7,359	703

The following table shows the distribution of 'loan to value' (LTV) ratios for the Credit Union's mortgage credit-impaired portfolio:

Mortgage portfolio – LTV distribution	2019 Credit impaired (carrying amount) $	2018 Credit impaired (carrying amount) $
Lower than 50%	2,326	752
50 to 60%	5,675	770
61 to 70%	2,027	3,858
71 to 80%	345	946
81 to 90%	-	335
91 to 100%	-	-
Higher than 100%	750	-
Total	11,123	6,661

(expressed in thousands of dollars)

Loans past due but not impaired

A loan is considered past due when a counterparty has not made a payment by the contractual due date. The following table presents the carrying value of loans that are past due but not classified as impaired because they are either:

i) less than 90 days past due and there is no information that an impairment event has occurred; or

ii) fully secured and collection efforts are reasonably expected to result in repayment.

Loans that are past due but not impaired are as follows:

				2019
	1-29 days $	30-89 days $	90 days and greater $	Total $
Personal Banking				
Residential mortgages	10,070	1,303	5	11,378
Loans measured at amortized cost	25	31	1	57
Loans measured at fair value	2,400	1,042	-	3,442
Business Banking mortgages and loans	1,377	482	-	1,859
	13,872	2,858	6	16,736

				2018
	1-29 days $	30-89 days $	90 days and greater $	Total $
Personal Banking				
Residential mortgages	11,363	1,868	-	13,231
Loans measured at amortized cost	134	200	-	334
Loans measured at fair value	4,709	2,444	-	7,153
Business Banking mortgages and loans	1,724	912	-	2,636
	17,930	5,424	-	23,354

(expressed in thousands of dollars)

The following table represents the maximum exposure to credit risk before taking into consideration any collateral. For financial assets recognized on the consolidated statement of financial position, the exposure to credit risk is their stated carrying amount. For loan commitments, the maximum exposure is the full amount of the committed facility including drawn and undrawn balances.

			2019	2018
Credit risk exposure	**Outstanding $**	**Undrawn commitments $**	**Total exposure $**	**Net $**
Cash and cash equivalents	11,251	-	11,251	48,156
Interest bearing deposits	397,532	-	397,532	386,159
Personal Banking				
Mortgages	1,964,146	66,818	2,030,964	2,039,680
Loans	83,128	556	83,684	115,038
Line of credit and overdraft	217,089	357,120	574,209	563,851
Business Banking				
Mortgages	903,060	88,841	991,901	878,771
Loans	25,922	847	26,769	27,083
Line of credit and overdraft	40,119	68,577	108,696	92,476
Accrued interest on loans	5,927	-	5,927	5,291
Derivative financial instruments	282	-	282	465
Investments	172,834	-	172,834	159,713
Accounts receivable	2,561	-	2,561	2,665
Income taxes receivable	408	-	408	535
Total exposure	3,824,259	582,759	4,407,018	4,319,883

The classes of financial instruments to which the Credit Union is most exposed are loans, cash resources and derivatives. The Credit Union often takes collateral as security in common with other lending institutions.

(expressed in thousands of dollars)

e) Prepayment risk

Prepayment risk is the risk that a borrower will exercise their right to make a lump sum or full payout of their loan prior to maturity. The impact and risk of a prepayment to the Credit Union is the reduced amount of interest income earned as compared to the interest income expected on the full borrowing contract based on the original terms without prepayment. When a prepayment is made, interest on the full borrowing contract is restricted to interest earned up to the point of prepayment rather than on the full contract to maturity. For the majority of the Credit Union's loan portfolio, prepayments result in a reduction of expected future income following the prepayment and does not result in a loss or reduction from interest accrued and earned prior to the date of prepayment.

i) Personal lons measured at fair value

In contrast, due to the nature of the contractual arrangements of this loan portfolio and classification and measurement at FVTPL, prepayment expectations are evaluated annually and incorporated into the fair value recorded on the statement of financial position and may contribute to a gain or loss on the change in fair value (note 7). Any such gain or loss is recorded through other income within the consolidated statement of income and comprehensive income (note 20).

The Credit Union has developed models to support the quantification of this prepayment risk which is incorporated into the risk adjusted cash flows in determining fair value. In measuring the prepayment risk the Credit Union estimates the probability of prepayment using historical trending based on loan vintage and age of the loan.

f) Liquidity risk

Liquidity risk is the risk that the Credit Union is unable to meet its financial obligations in a timely manner as they fall due. The Credit Union will at all times maintain statutory liquidity levels with Central 1 as required by regulations. Included in cash and cash equivalents and interest bearing deposits are the minimum liquidity threshold cash resources of $293,201 (2018 – $289,894).

Accordingly, the Credit Union has policies and procedures in place to manage its liquidity position to comply with both regulatory requirements and sound business practices.

i) Management of liquidity risk

Effective liquidity risk management is essential in order to ensure that the Credit Union maintains sufficient liquidity to meet its liabilities when due, to manage the cost of funds, and to enable the lines of business to continue to generate revenue, even under adverse circumstances.

(expressed in thousands of dollars)

Liquidity risk is managed within and on both an operational and strategic level on a total Credit Union basis and is approved by the Board. The desired liquidity level above the statutory requirement is determined by taking into account the balance between the cost of liquidity and the yield achieved. Contingency liquidity is managed by having a plan in place that can be invoked very quickly, as well as having a diversity of funding sources arranged that can be accessed when needed.

The Board receives reports on risk exposures and performance against approved limits. Oversight of liquidity risk is achieved through the Asset and Liability Committee (ALCO) who meet regularly to review the Credit Union's liquidity profile.

The key elements of liquidity risk management are measurement and modeling, reporting, stress testing, contingency planning and funding diversification.

ii) Liquidity risk exposure

The following table showing cash flows associated with remaining contractual maturities represents the Credit Union's exposure to liquidity risk.

	Less than 1 year $	1 – 3 years $	4 – 5 years $	5 years onwards $	Total $
2019					
Deposits	2,556,120	546,412	-	-	3,102,532
Lease liabilities	3,214	5,411	4,571	2,172	15,368
Borrowings					
Money market loans	54,998	-	-	-	54,998
Subordinated debt	-	-	15,000	-	15,000
Secured borrowings	50,045	344,755	111,486	-	506,286
Derivative liabilities	-	1,809	-	-	1,809
2018					
Deposits	2,451,382	609,267	-	-	3,060,649
Borrowings					
Money market loans	44,891	-	-	-	44,891
Subordinated debt	-	-	15,000		15,000
Secured borrowings	61,586	460,028	-	-	521,614
Derivative liabilities	-	3,778	-	-	3,778

g) Market risk

Market risk is the risk that changes in market prices, such as interest rates, foreign exchange rates and credit spreads will affect the Credit Union's income or the value of its holdings of financial instruments.

The Board reviews and approves market risk policies and limits annually. The application of the framework and monitoring of the Credit Union's market risk exposures and the activities that give risk to these exposures are overseen through the ALCO. The Credit Union establishes specific operating policies and sets limits at the product, portfolio, line of business and corporate-wide levels which are reviewed at least annually.

(expressed in thousands of dollars)

The principal market risk to which the Credit Union is exposed is interest rate risk.

- Interest rate risk management

  The primary objective of interest rate risk management is to manage exposure to the risk within controllable and acceptable levels while maximizing profitability for the given level of risk. This is achieved through effective structuring of the consolidated statement of financial position and through the use of swaps and other derivative instruments which are used to adjust the exposure to interest rate risk by modifying the repricing of the Credit Union's financial instruments. The Credit Union's derivative instruments are disclosed in note 27.

- Interest rate risk measurement

  The Credit Union engages a number of interest rate risk measurement techniques to inform the analysis and management activities including the use of asset-liability and interest rate sensitivity simulation models, gap analysis and duration analysis.

  Sensitivity analysis is used to assess the change in value of the Credit Union's financial instruments against a range of incremental basis point changes in interest rates over a 12-month period. Interest rate shock analysis is calculated in a similar manner to sensitivity analysis but involves a more significant change of 100 basis points or greater in interest rates. Sensitivity analysis and interest rate shock analysis are calculated on a monthly basis and are reported to the ALCO. Based on current differences between financial assets and financial liabilities as at December 31, 2019, the Credit Union estimates that an immediate and sustained 100 basis point increase in interest rates would decrease net interest income by $676 (2018 –decrease of $1,608) over the next 12 months while an immediate and sustained 100 basis point decrease in interest rates would decrease net interest income by $852 (2018 – increase of $217) over the next 12 months.

  Gap analysis is used to assess the interest rate risk through analysis of the balances, interest rates and timing of maturity of assets and liabilities. An interest rate gap is represented by a difference in net cash flows in a particular period which is subject to a mismatch in repricing.

  The following table represents the carrying amounts of interest-sensitive assets and liabilities presented in the periods in which they next reprice to market rates or mature and are summed to show the interest rate and maturity gap. The information represents the position outstanding at the close of the business day and may change significantly in subsequent periods based on member behaviour and the application of the Credit Union's asset and liability management policies.

  Fixed term assets, such as residential mortgage loans and consumer loans, are reported based on scheduled repayments. Assets that are related to the Credit Union's prime rate or other short-term market rates are reported in the variable rate category.

(expressed in thousands of dollars)

Fixed rate liabilities, such as term deposits, are reported at scheduled maturity. Interest bearing deposits on which the interest rate changes with prime rate or other short-term market rates are reported within the variable rate category.

Yields are based on the effective interest rates for the assets and liabilities at the reporting date.

2019

	Weighted average rate %	Variable rate $	Within 3 months $	3 months to 1 year $	1 to 5 years $	Over 5 years $	Non-interest sensitive $	Total $
Assets								
Cash and cash equivalents	0.00	-	2,000	-	-	-	9,251	11,251
Interest bearing deposits	1.46	-	55,348	53,296	288,888		-	397,532
Derivative financial instruments	1.72	-	2	273	7	-	-	282
Loans	3.58	787,398	89,898	247,011	2,053,374	56,180	708	3,234,569
Investments	1.78	16,183	39,288	17,104	93,953	-	6,306	172,834
Other		--	-	-	-	-	33,308	33,308
		803,581	186,536	317,684	2,436,222	56,180	49,573	3,849,776
Liabilities and Members' Equity								
Borrowings	1.91	-	54,998	307,028	199,258	15,000	-	576,284
Deposits	2.28	906,909	295,333	1,327,455	546,412	-	26,423	3,102,532
Derivative financial instruments	1.42	-	-	-	1,809	-		1,809
Other		-	-	-	-	-	171,266	171,266
		906,909	350,331	1,634,483	747,479	15,000	197,689	3,851,891
Statement of financial position mismatch		(103,328)	(163,795)	(1,316,799)	1,688,743	41,179	(146,000)	-
Notional amount of derivatives		-	(140,000)	-	140,000	-	-	-
Net mismatch		(103,328)	(303,795)	(1,316,799)	1,828,743	41,179	(146,000)	-

(expressed in thousands of dollars)

2018

	Weighted average rate %	Variable rate $	Within 3 months $	3 months to 1 year $	1 to 5 years $	Over 5 years $	Non-interest sensitive $	Total $
Assets								
Cash and cash equivalents	0.00	-	23,000	-	-	-	25,156	48,156
Interest bearing deposits	1.47	-	-	10,000	376,159	-	-	386,159
Derivative financial instruments	1.82		2	1	462			465
Loans	3.36	832,358	73,142	185,570	1,998,343	91,974	2,373	3,183,760
Investments	1.92	15,894	12,261	35,631	89,677	-	6,250	159,713
Other		-	-	-	-	-	19,963	19,963
		848,252	108,405	231,202	2,464,641	91,974	53,742	3,798,216
Liabilities and Members' Equity								
Borrowings	1.89	-	44,893	61,584	460,028	15,000	-	581,505
Deposits	2.16	893,809	541,213	993,011	609,267	-	23,349	3,060,649
Derivative financial instruments	1.83	-	-	-	3,778	-	-	3,778
Other		-	-	-	-	-	152,284	152,284
		893,809	586,106	1,054,595	1,073,073	15,000	175,633	3,798,216
Statement of financial position mismatch		(45,557)	(477,701)	(823,393)	1,391,568	76,974	(121,891)	-
Notional amount of derivatives		-	(234,000)	44,000	190,000	-	-	-
Net mismatch		(45,557)	(711,701)	(779,393)	1,581,568	76,974	(121,891)	-

h) Foreign exchange risk

Foreign exchange risk is not considered significant at this time as the Credit Union does not engage in any active trading of foreign currency positions or hold significant foreign currency denominated financial instruments for an extended period. Foreign currency denominated deposits are matched with foreign currency denominated liquidity to minimize any exposure. Foreign exchange revenues earned by the Credit Union are primarily generated by crystallized spreads on dollars exchanged with members.

26 Capital management

The FIA requires the Credit Union to maintain, at all times, a capital base which is adequate in relation to its business. Capital levels for credit unions in British Columbia are regulated pursuant to guidelines issued by the BC Financial Services Authority (BCFSA, formerly the Financial Institutions Commission FICOM). Minimum capital standards are based on a total capital to risk weighted assets (RWA) ratio of 8%, along with a requirement that at least 35% of the capital base consist of retained earnings. The Credit Union met this requirement at December 31, 2019 and December 31, 2018. Capital is managed in accordance with policies established by the Board. Management regards a strong capital base as an integral part of the Credit Union's strategy. The Credit Union has a capital plan to provide a long-term forecast of capital requirements. All of the elements of capital are monitored throughout the year, and modifications of capital management strategies are made as appropriate.

(expressed in thousands of dollars)

The capital ratio as determined by BCFSA's prescribed rules relating to on-statement of financial position and off-statement of financial position exposures is calculated by dividing total capital by RWA, which is the assets weighted according to relative risk (0% to 150%).

The total capital is as follows:

	2019 $	2018 $
Equity shares	2,973	6,814
Retained earnings (non-consolidated)	141,839	142,967
Deferred income tax assets	(2,566)	(2,480)
50% of the Credit Union's proportion of retained earnings in CUDIC, Central 1 and Stabilization Central Credit Union as advised by BCFSA	38,009	39,177
Subordinated debt	15,000	15,000
Deductions from capital	(244)	(689)
	195,011	200,789

27 Derivative financial instruments and hedge accounting

The table below provides an analysis of the Credit Union's derivative-related credit exposure:

	2019		2018	
	Notional amount $	Fair value $	Notional amount $	Fair value $
Equity options	169	14	277	11
Interest rate swaps	180,000	(1,541)	314,000	(3,324)
		(1,527)		(3,313)

Notional amounts are the contract amounts used to calculate the cash flows to be exchanged; they do not represent credit or market risk exposure.

The table below presents the recognized financial instruments that are subject to enforceable master netting arrangements but not offset and shows the result if all set-off rights were exercised.

	Net amounts not offset $
2019	
Derivative assets	268
Derivative liabilities	(1,809)

(expressed in thousands of dollars)

	Net amounts not offset $
2018	
Derivative assets	454
Derivative liabilities	(3,778)

The Credit Union is subject to an enforceable master netting arrangement in the form of an International Swaps and Derivatives Association (ISDA) agreement with a derivative counterparty. Under the terms of that agreement, offsetting of derivative contracts is permitted only in the event of bankruptcy or default of either party to the agreement. No amounts are offset and presented net on the consolidated statement of financial position.

Fair values based on quoted market prices are not available for a significant portion of the Credit Union's derivative instruments. Consequently, fair values are derived using present value and other valuation techniques and may not be indicative of the net realizable values.

The following is a summary of the nature of derivative instruments utilized:

a) Interest rate swaps are transactions in which two parties exchange interest flows on a specified notional amount for a predetermined period, based on agreed upon fixed and floating rates. Notional amounts are not exchanged.

   The Credit Union hedges a portion of the interest rate risk that arises on variable interest cash flows on prime rate mortgages through interest rate derivatives. Interest income and expense include the release from other reserves of gains or losses relating to the effective portion of qualifying hedging derivatives designated as cash flow hedges either:

   i) as the hedged item is recorded in interest income (expense); or

   ii) when the forecasted cash flow of the hedged item is no longer probable.

   Any ineffectiveness in the hedging relationship is recorded directly in the consolidated statement of income.

   During the year ended December 31, 2019, $2,639 (net of tax of $230) (2018 – $1,205 (net of tax of $246) was the effective portion of changes in fair value for cash flow hedges in the year. This amount is recorded in comprehensive income and represents unrealized net gains on derivatives of $1,124 and a further $1,515 representing the unamortized portion of realized gains on swaps unwound during the year for which the underlying hedged instrument is still in place. These gains are transferred from other comprehensive income to net interest income over the remaining life of the underlying hedged instrument. The amount transferred to net interest income during the year was $400 (2018 – $nil). The ineffective portion of the unrealized fair value transferred to the consolidated statement of income was $125 (net of tax of $25) (2018 – $66 (net of tax of $14)).

(expressed in thousands of dollars)

From time to time, the Credit Union enters into derivative transactions to economically hedge certain business strategies that do not otherwise qualify for hedge accounting, or where hedge accounting is not considered economically feasible to implement, designated and referred to as fair value hedges. During the year ended December 31, 2019, $270 (2018 – $248) was recorded in net interest income as unrealized changes in fair value of these derivatives. In addition, net interest income includes $305 (2018 –$194) in realized net losses.

b) Index-linked call options are equity contracts to pay or receive cash flows based on the increase or decrease in the underlying index or security. The Credit Union utilizes index-linked option contracts in order to economically hedge interest expense on the equity index-linked deposits.

The fair value of all outstanding derivative contracts in a gain position, which takes into account credit risk without factoring in the impact of master netting agreements, totalled $265 as at December 31, 2019 (2018 – $617). The Credit Union manages this credit risk by dealing with counterparties with a minimum credit rating of "A", and setting specific limits for investments with those counterparties, which are reviewed monthly.

The following table contains details of the hedging instruments used in the Credit Union's hedging strategies:

					Carryng amount
	Notional $	Assets $	Liabilities $	Balance sheet line item(s)	Changes in fair value used for calculating ineffectiveness $
Cash flow hedges	160,000	-	1,809	Derivatives	1,706
Fair value hedges	20,000	265	-	Derivatives	-

The following table contains information regarding the effectiveness of the hedging relationships designated by the Credit Union, as well as the impacts on net income and other comprehensive income (net of tax):

		Hedge ineffectiveness recognized in P&L		Amounts reclassified from reserves to P&L as	
	Gain (loss) recognized in OCI $	Ineffectiveness $	Interest on cash resources and investments	Hedged item affected P&L $	P&L line item that includes reclassified amount $
Cash flow hedges	1,124	150	Interest on cash resources and investments	150	Interest on cash resources and investments

(expressed in thousands of dollars)

28 Fair value of financial instruments

The Credit Union has estimated fair values taking into account changes in interest rates and credit risk that have occurred since the assets and liabilities were acquired. These calculations represent management's best estimates based on a range of methods and assumptions; since they involve uncertainties, the fair values may not be realized in an actual sale or immediate settlement of the instruments. Interest rate changes are the main cause of changes in the fair value of the Credit Union's financial instruments. The carrying value is a reasonable approximation of fair value for the Credit Union's cash and cash equivalents, demand deposits, and certain investments.

The fair values of financial instruments are as follows:

a) Interest bearing deposits

The fair value of interest bearing deposits is determined by discounting remaining contractual cash flows at current market interest rates offered for deposits with similar terms and risks.

b) Derivative financial instruments

The fair value of derivative financial instruments is determined by using quoted market benchmark rates from an independent source. The Credit Union uses a valuation method that includes discounted cash flows on the remaining contractual life of a derivative instrument, and valuation models that use observable market data together with a consideration of the credit risk of both parties to the derivative.

c) Loans

In determining the fair value of loans measured at amortized cost on the consolidated statement of financial position, the Credit Union incorporates the following assumptions:

i) Fair values are determined by discounting remaining contractual cash flows at current market interest rates offered for loans with similar terms, adjusting for estimated prepayments expected.

ii) Fair values are determined by discounting remaining expected cash flows adjusted for prepayment and credit risk at current risk free rates plus an instrument specific spread.

(expressed in thousands of dollars)

d) Investments

The majority of the Credit Union's investments are fair valued based on market pricing with the exception of certain investments that are measured at cost as the approximate fair value. These investments are the Level 3 investments discussed later in this note, which include shares in other investments that were issued in a private offering, and have no active market or are not publically traded. As a result, the fair value of these investments cannot be determined and consequently these investments are measured at amortized cost. The Credit Union has no immediate plans for disposal of any of these investments.

Also included in the Level 3 investments are Central 1 equity shares and accrued dividends. As discussed earlier in note 9, the execution and announcement of Class E share redemption during the year provided assurance of the realizable portion of 4,211 shares at a redemption value of $100. However, the remaining Class E shares are recorded at cost as there is no separately quoted market value for these shares and it has been determined that cost approximates the fair value. During the year ended December 31, 2019, $46 (net of tax of $10) (2018 – $(273) (net of tax of ($56)) was recognized in other comprehensive income (loss) for the year, as an unrealized change in fair value of investments held at FVOCI under IFRS 9.

e) Borrowings

The fair value of borrowings is determined by discounting remaining contractual cash flows at current market interest rates offered for borrowings with similar terms and risks.

f) Deposits

In determining the fair value of deposits, the Credit Union incorporates the following assumptions:

i) For fixed rate, fixed maturity deposits, the Credit Union discounts the remaining contractual cash flows, adjusted for expected redemptions, at market interest rates offered for deposits with similar terms and risks.

ii) For floating rate deposits, changes in interest rates have minimal impact on the fair value since deposits reprice to market frequently. On that basis, fair value is assumed to equal the carrying value.

(expressed in thousands of dollars)

The following represents the approximate fair values of financial instruments of the Credit Union as at the consolidated statement of financial position date:

			2019			2018
	Carrying value $	Fair value $	Difference $	Carrying value $	Fair value $	Difference $
Financial assets						
Interest bearing deposits	397,532	394,255	(3,277)	386,159	378,639	(7,520)
Derivative financial instruments	282	282	-	465	465	-
Investments	172,834	172,749	(85)	159,713	159,017	(696)
Loans	3,234,308	3,201,168	(33,140)	3,180,984	3,122,812	(58,172)
Financial liabilities						
Borrowings	576,284	581,642	5,358	581,505	591,413	9,908
Deposits	3,102,300	3,091,303	(10,997)	3,060,878	3,063,503	2,625
Derivative financial instruments	1,809	1,809	-	3,778	3,778	-

The following tables summarize the fair value of financial instruments which are accounted for at fair value on the Credit Union's consolidated statement of financial position or disclosed at fair value elsewhere in the notes to the consolidated financial statements. Fair value measurements are analyzed according to a fair value hierarchy of three levels based on the lowest level of inputs, as outlined below. Observable inputs represent instances where market data is obtained from independent sources. Unobservable inputs are based on the Credit Union's own internal assumptions. There were no transfers between levels for the current year.

Level 1: Unadjusted market prices in active markets for identical assets and liabilities.

Level 2: Inputs, other than quoted prices included within Level 1, that are observable for the asset or liability either directly or indirectly. This level includes the majority of over the counter derivatives and certain monetary instruments.

Level 3: Inputs which are not based upon market observable data.

(expressed in thousands of dollars)

	2019		
	Level 1	**Level 2**	**Level 3**
	$	**$**	**$**
Financial assets			
Interest bearing deposits	-	394,255	-
Derivative financial instruments	-	282	-
Investments	-	154,643	18,106
Loans	-	3,133,075	68,093
Financial liabilities			
Borrowings	-	(581,642)	-
Deposits	-	(3,091,303)	
Derivative financial instruments	-	(1,809)	-
	-	7,501	86,199

	2018		
	Level 1	**Level 2**	**Level 3**
	$	**$**	**$**
Financial assets			
Interest bearing deposits	-	378,639	-
Derivative financial instruments	-	465	-
Investments	-	141,200	17,817
Loans	-	3,026,513	96,299
Financial liabilities			
Borrowings	-	(591,413)	-
Deposits	-	(3,063,503)	-
Derivative financial instruments	-	(3,778)	-
	-	(111,877)	114,116

The Credit Union has financial instruments classified as Level 3 in the fair value hierarchy and has provided an analysis of movements in Level 3:

	2019	**2018**
	$	**$**
At January 1	114,116	156,818
Changes in loans measured at fair value (note 7)	(28,206)	(44,012)
Changes in Central 1 equity shares and other investments	289	1,310
At December 31	86,199	114,116

(expressed in thousands of dollars)

29 Related party disclosure

Related parties of the Credit Union include subsidiaries, associates, post-employment benefit plans, directors and other key management personnel (key management), close family members of key management and entities which are controlled, jointly controlled or significantly influenced, or in which significant voting power is held, by key management or their close family members.

a) Loans and deposits

The Credit Union provides banking services to key management and persons connected to them.

A number of transactions were entered into with key management in the normal course of business. All loans to directors, executive management and employees of the Credit Union are subject to the credit policies established for all members. Credit Union employees may receive special rates or other considerations with respect to loans at the Credit Union. Directors do not receive special rates or other considerations with respect to loans or deposits at the Credit Union.

No provisions or loan write-offs have been recognized in respect of loans given to related parties (2018 – $nil).

		2019 $	2018 $
i)	Loans to related parties:		
	Loans outstanding at January 1	4,361	4,931
	Loans issued in the year	1,910	3,564
	Loan repayments in the year	(2,454)	(4,134)
	Loans outstanding at December 31	3,817	4,361
	Interest income earned	104	129
ii)	Deposits from related parties:		
	Balance on deposit at January 1	4,017	6,731
	Deposits received in the year	10,177	16,214
	Deposits repaid in the year	(9,575)	(18,928)
	Balance on deposit at December 31	4,619	4,017
	Interest expense on deposits	80	87

(expressed in thousands of dollars)

b) Key management compensation

	2019 $	2018 $
Salary and other short-term employee benefits	3,089	3,306
Post-employment benefits	339	313
Other long-term benefits	9	6
Termination benefits	1,938	83
	5,375	3,708

30 Subsequent events

Pursuant to Section 20 of the Credit Union Incorporation Act (British Columbia) and in accordance with guidelines provided for in BCFSA's Bulletin No. CU-18-001, Westminster Savings Credit Union ("Westminster") and Prospera Credit Union ("Prospera") amalgamated effective January 1, 2020 (the "amalgamation date") to form a single credit union that will operate under the name Prospera Credit Union ("New Prospera") (the "amalgamation").

On the amalgamation date, the issued shares of Westminster and Prospera were exchanged for shares in New Prospera as follows:

a) one (1) Class A Membership Equity Share of New Prospera was issued in exchange for each issued Class A Membership Equity Share of Westminster; and

b) one (1) Class A Membership Equity Share of New Prospera was issued in exchange for each issued Class A Membership Equity Share of Prospera.

Following the share exchange, New Prospera will redeem from any member holding in excess of five (5) Class A Membership Equity Shares, those shares that are in excess. Westminster and Prospera combined their respective operations by way of amalgamation to build on the strengths of each credit union to recognize operational synergies and to capture economies of scale as a combined entity.

Key dates of the amalgamation:

a) February 28, 2019 – The credit unions submitted an Application for Consent to the proposed amalgamation of Prospera and Westminster to BCFSA.

b) September 23, 2019 – Consent to the proposed amalgamation of Prospera and Westminster issued by BCFSA.

c) September 26, 2019 – Westminster and Prospera entered into an agreement to combine their businesses.

(expressed in thousands of dollars)

d) November 21, 2019 – The amalgamation was voted on and approved by members of both credit unions.

e) January 1, 2020 – Acquisition date

Westminster was incorporated pursuant to the Credit Union Incorporation Act of British Columbia and its operations were subject to the FIA. Westminster's primary business activities includes providing financial services to its members and the general public across British Columbia. It provides personal banking, business banking, and wealth management services through a network of 13 branches, online and mobile banking, the Exchange ATM network and contact centre. Through its subsidiaries, WS Leasing Ltd. and Mercado Capital Corporation, Westminster offers vehicle and equipment leasing to individuals and businesses in all provinces and territories in Canada, except Quebec.

The amalgamation will be accounted for using the acquisition method as determined under IFRS 3 – Business Combinations (IFRS 3). Consideration is measured at the aggregate of the fair values of assets transferred, liabilities incurred or assumed, and equity instruments issued in exchange for control of the acquiree at the acquisition date. The acquisition date is the date the acquirer obtains control over the acquiree. At the acquisition date, the identifiable assets acquired and liabilities assumed are recognized at their fair values with the exception of certain items such as deferred taxes and employee benefit arrangements, where IFRS provides exceptions to recording amounts at fair value. Acquisition related costs are recognized in net income as incurred. The excess of consideration transferred over the net of the acquisition date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with IFRS 3, is recorded as goodwill. If the total consideration is less than the net of the identifiable assets acquired and the liabilities assumed, a purchase gain is recognized in earnings.

Due to the timing of the amalgamation, the accounting acquirer has not yet been determined. Judgment is required to determine which entity is the acquirer. In identifying the acquirer, the credit unions are considering, among others, the voting rights of all equity instruments exchanged into New Prospera, the corporate governance structure of New Prospera, the composition of senior management of New Prospera, the relative size of each of the credit unions and tax considerations. In addition, given the ongoing nature of the fair value process in determining the identifiable assets acquired and liabilities assumed and consideration transferred, a preliminary purchase price allocation was not available as of March 13, 2020.

Goodwill, if any, could result from the ability of the combined business to grow its relationships with existing members and attract new members as a result of improved product offerings, quality of service and convenience, resulting from benefits driven by the increased size and scale of the combined business.

Prospera has incurred costs of $5,423 (2018 – $1,546) related to the amalgamation and ongoing integration efforts. These costs were recognized under salaries and employee benefits, administration, and other expenses in the consolidated statement of income.