

Prospera Credit Union

Consolidated Financial Statements
December 31, 2018
(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, 2018 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, 2018;
- 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.

Other information

Management is responsible for the other information. The other information obtained prior to the date of this auditor's report comprises the Management's Discussion and Analysis.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

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In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed on the other information obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

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 27, 2019

Prospera Credit Union

Consolidated Statement of Financial Position

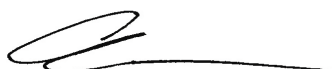
As at December 31, 2018

(expressed in thousands of dollars)

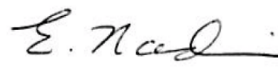
	2018 \$	2017 \$
Assets		
Cash and cash equivalents	48,156	7,630
Interest bearing deposits	386,159	402,830
Loans (note 7)	3,183,760	2,974,914
Other assets (note 11)	7,138	9,535
Derivative financial instruments (note 26)	465	67
Investments (note 9)	159,713	140,957
Property, premises and equipment (note 10)	8,140	8,134
Intangibles (note 12)	1,044	1,500
Retirement benefit asset (note 16)	539	583
Deferred income tax assets (note 22)	2,567	2,233
Income taxes receivable	535	579
TOTAL ASSETS	3,798,216	3,548,962
Liabilities		
Borrowings (note 13)	581,505	482,774
Deposits (note 14)	3,060,649	2,904,463
Retirement benefit obligation (note 16)	7,526	9,721
Derivative financial instruments (note 26)	3,778	5,027
Other liabilities (note 17)	6,346	11,061
TOTAL LIABILITIES	3,659,804	3,413,046
Members' Equity		
Capital and reserves attributable to members		
Members' equity shares (note 15(c))	3,059	3,213
Retained earnings	142,998	140,218
Other reserves	(7,645)	(7,515)
TOTAL MEMBERS' EQUITY	138,412	135,916
TOTAL LIABILITIES AND MEMBERS' EQUITY	3,798,216	3,548,962

Commitments and contingent liabilities (notes 16 and 23)

Approved by the Board of Directors



Director



Director

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, 2018

(expressed in thousands of dollars)

	2018 \$	2017 \$
Interest income		
Loans and receivables measured at amortized cost	102,672	93,455
Financial instruments measured at fair value through profit and loss	11,613	-
Interest bearing deposits and investments	8,243	9,516
	<u>122,528</u>	<u>102,971</u>
Interest expense		
Deposits	44,517	33,960
Borrowings	10,958	6,336
	<u>55,475</u>	<u>40,296</u>
Net interest income (note 18)	67,053	62,675
Credit impairment losses (note 7)	150	156
Impairment loss on financial assets (note 6)	-	7,493
Net interest income after provision and impairment charges	66,903	55,026
Other income (note 19)	(1,171)	14,830
Net interest income and other income	<u>65,732</u>	<u>69,856</u>
Non-interest expenses		
Salaries and employee benefits (note 20)	32,654	33,745
Occupancy	7,444	7,489
Administration	7,392	5,683
Other expenses (note 21)	6,686	4,948
Data processing	3,525	3,182
Depreciation and amortization	2,370	2,296
Communication and marketing	2,103	2,384
Clearing charges	1,547	1,481
	<u>63,721</u>	<u>61,208</u>
Income before dividends on member deposit shares	2,011	8,648
Dividends on member deposit shares	74	47
Income before income taxes	<u>1,937</u>	<u>8,601</u>
Provision for income taxes (note 22)		
Current	521	1,251
Deferred	(76)	554
	<u>445</u>	<u>1,805</u>
Net income for the year	<u>1,492</u>	<u>6,796</u>
Other comprehensive income (loss) for the year		
Changes related to defined benefit plans (note 16(e))	1,450	(1,746)
Change in fair value of cash flow hedges (note 26)	1,205	(3,154)
Change in fair value of investments (note 27)	(273)	2,668
	<u>2,382</u>	<u>(2,232)</u>
Comprehensive income	<u>3,874</u>	<u>4,564</u>

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, 2018

(expressed in thousands of dollars)

	Members' equity shares \$	Retained earnings \$	Defined benefit plans ¹ \$	Other reserves		Members' equity \$
				Cash flow hedges and retained interest ² \$	Investments ³ \$	
Balance – December 31, 2016	3,510	133,511	(4,695)	(583)	(5)	131,738
Net income and other comprehensive income	-	6,796	(1,746)	(3,154)	2,668	4,564
Dividends on members' equity shares	-	(89)	-	-	-	(89)
Share redemptions	(297)	-	-	-	-	(297)
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

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, 2018

(expressed in thousands of dollars)

	2018	2017
	\$	\$
Cash provided by (used in)		
Operating activities		
Net income for the year	1,492	6,796
Items not affecting cash		
Net interest income	(67,053)	(62,675)
Depreciation and amortization	2,370	2,296
Provision for expected credit losses and impairment loss on financial assets	150	7,649
Provision for current income taxes	521	1,251
Deferred income taxes	(76)	554
Net change in fair value of derivative financial instruments (note 27)	(241)	1,852
Net change in fair value of secured borrowings	(2,910)	(1,289)
Net change in fair value of investments	329	(3,208)
Net gain (loss) in fair value of loans held at fair value through profit and loss (note 6)	(15,381)	-
Loss on sale of property, premises and equipment	42	7
	(80,757)	(46,767)
Net change in loans	(194,745)	(317,387)
Net change in deposits	156,388	212,523
Interest received	121,197	102,176
Interest paid	(49,954)	(38,951)
Issuance of member deposit shares	204	193
Redemption of member deposit shares	(255)	(286)
Dividends paid	(151)	(153)
Change in other assets and retirement benefit asset	2,441	(3,549)
Net change in derivative financial instruments	1,647	(6,023)
Change in other liabilities and retirement benefit obligation	(4,655)	5,060
Income taxes paid	(972)	(2,098)
Other items	(7,003)	9,480
	(56,615)	(85,782)
Investing activities		
Investment in term deposits	(21,000)	(180,271)
Proceeds from maturity of term deposits	37,671	213,695
Purchase of investments	(281,064)	(373,919)
Proceeds from the sale and maturity of investments	261,978	332,515
Additions to property, premises, equipment and intangibles	(1,931)	(2,741)
	(4,346)	(10,721)
Financing activities		
Proceeds from borrowed funds	45,000	43,536
Proceeds from securitization transactions	146,880	94,332
Repayments of borrowed funds	(28,536)	-
Repayments of secured borrowings	(61,703)	(65,337)
Redemption of members' equity shares	(154)	(297)
	101,487	72,234
Increase (decrease) in cash and cash equivalents	40,526	(24,269)
Cash and cash equivalents – Beginning of year	7,630	31,899
Cash and cash equivalents – End of year	48,156	7,630
Cash and cash equivalents consist of:		
Demand deposits and clearings with Central 1	25,156	7,630
Term deposits with Central 1 with less than 90 days to maturity	23,000	-
	48,156	7,630

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

Prospera Credit Union

Notes to Consolidated Financial Statements

December 31, 2018

(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 14, 2019.

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 effective for the year ended December 31, 2018, as issued and effective.

b) Basis of measurement

For the period ending December 31, 2017, the consolidated financial statements have been prepared on the historical cost basis, except for available-for-sale (AFS) financial assets, financial assets and financial liabilities accounted for at fair value through profit or loss (FVTPL) and all derivative financial instruments, which are measured at fair value.

For the period beginning January 1, 2018, the Credit Union has adopted IFRS 9 – Financial Instruments (IFRS 9) and classifies its financial assets in the following measurement categories: FVTPL, FVOCI, or amortized cost. Financial liabilities accounted for at FVTPL and all derivative financial instruments continue to be 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.

Prospera Credit Union

Notes to Consolidated Financial Statements

December 31, 2018

(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 9 – Financial Instruments (IFRS 9) as issued by the IASB in July 2014 with a date of transition of January 1, 2018, which resulted in changes in accounting policies and adjustments to the amounts previously recognized in the consolidated financial statements. The Credit Union did not early adopt any of IFRS 9 in previous periods.

As permitted by the transitional provisions of IFRS 9, the Credit Union elected not to restate comparative figures. Any adjustments to the carrying amounts of financial assets and liabilities at the date of transition were recognized in the opening retained earnings of the current period. The Credit Union has also elected to continue to apply the hedge accounting requirements of International Accounting Standard (IAS) 39 – Financial Instruments: Recognition and Measurement (IAS 39) on the adoption of IFRS 9.

Consequently, amendments to IFRS 7 – Financial Instruments: Disclosures (IFRS 7) have been applied to the current period only. The comparative period note disclosures reflect disclosures applicable for that period and have not been changed.

The adoption of IFRS 9 has resulted in changes in the Credit Union's accounting policies for recognition, classification and measurement of financial assets and financial liabilities and impairment of financial assets. IFRS 9 also significantly amends other standards dealing with financial instruments such as IFRS 7.

Prospera Credit Union

Notes to Consolidated Financial Statements

December 31, 2018

(expressed in thousands of dollars)

Set out below are disclosures relating to the impact of the adoption of IFRS 9 on the Credit Union. Further details of the specific IFRS 9 accounting policies applied in the current period (as well as the previous IAS 39 accounting policies applied in the comparative period) are described in more detail below.

a) Classification and measurement of financial instruments

The measurement category and the carrying amount of financial assets and liabilities in accordance with IAS 39 and IFRS 9 at January 1, 2018 are compared as follows:

		IAS 39		IFRS 9
	Measurement category	Carrying amount \$	Measurement category	Carrying amount \$
Cash and cash equivalents and interest bearing deposits	Amortized cost (loans and receivables)	410,460	Amortized cost	410,460
Loans	Amortized cost (loans and receivables)	2,974,914	Amortized cost	2,833,242
	FVTPL (loans and receivables)	-	FVTPL	140,311
Investments	(FVOCI) (Available for sale)	13,194	FVOCI	13,194
	Amortized cost (held to maturity)	127,763	Amortized cost	127,763
Derivative financial instruments	FVTPL (hedging instrument)	67	FVTPL (mandatory)	67
Other assets	Amortized cost (loans and receivables)	22,564	Amortized cost	22,564

There were no changes to the classification and measurement of financial liabilities.

b) Reconciliation of the consolidated statement of financial position from IAS 39 to IFRS 9

The Credit Union performed a detailed analysis of its business models for managing financial assets and cash flow characteristics of the assets.

Prospera Credit Union
Notes to Consolidated Financial Statements
December 31, 2018

(expressed in thousands of dollars)

The following table reconciles the carrying amounts of financial assets, from their previous measurement category in accordance with IAS 39 to their new measurement categories upon transition to IFRS 9 on January 1, 2018:

Measurement category	IAS 39 carrying amount December 31, 2017 \$	Reclassifications \$	Remeasurements \$	IFRS 9 carrying amount January 1, 2018 \$
Amortized cost				
Cash and cash equivalents and interest bearing deposits				
Opening balance under IAS 39 and closing balance under IFRS 9	410,460	-	-	410,460
Loans				
Opening balance under IAS 39	2,974,914	-	-	-
Remeasurement: ECL allowance	-	-	(1,361)	-
Subtraction: To FVTPL (IFRS 9)	-	140,311	-	-
Closing balance under IFRS 9	-	-	-	2,833,242
Investments – amortized cost				
Opening balance under IAS 39	-	-	-	-
Addition: From held to maturity (IAS 39)	-	127,763	-	-
Closing balance under IFRS 9	-	-	-	127,763
Investments – held to maturity				
Opening balance under IAS 39 and closing balance under IFRS 9	127,763	-	-	-
Subtraction: To amortized cost (IFRS 9)	-	127,763	-	-
Closing balance under IFRS 9	-	-	-	-
Other assets				
Opening balance under IAS 39	22,564	-	-	22,564
Closing balance under IFRS 9	-	-	-	-
Total financial assets measured at amortized cost	3,535,701	(140,311)	(1,361)	3,394,029

Prospera Credit Union
Notes to Consolidated Financial Statements
December 31, 2018

(expressed in thousands of dollars)

Measurement category	IAS 39 carrying amount December 31, 2017 \$	Reclassifications \$	Remeasurements \$	IFRS 9 carrying amount January 1, 2018 \$
Fair value through profit or loss (FVTPL)				
Loans and receivables				
Opening balance under IAS 39	-	-	-	-
Addition: From amortized cost (IAS 39)	-	140,311	-	-
Closing balance under IFRS 9	-	-	-	140,311
Derivatives				
Opening balance under IAS 39 and closing balance under IFRS 9	67	-	-	67
Total financial assets measured at FVTPL	67	140,311	-	140,378
Fair value through other comprehensive income (FVOCI)				
-	-	-	-	-
Investments – Available for sale financial assets				
Opening balance under IAS 39	13,194	-	-	-
Subtraction: To FVOCI (IFRS 9)	-	13,194	-	-
Closing balance under IFRS 9	-	-	-	-
Investments – FVOCI				
Opening balance under IAS 39	-	-	-	-
Addition: From Available for sale (IAS 39)	-	13,194	-	-
Closing balance under IFRS 9	-	-	-	13,194
Total financial assets measured at FVOCI	13,194	-	-	13,194

The total remeasurement loss of \$1,130 was recognized in the opening retained earnings at January 1, 2018, net of tax of \$231.

Prospera Credit Union
Notes to Consolidated Financial Statements
December 31, 2018

(expressed in thousands of dollars)

The following explains how applying the new classification requirements of IFRS 9 led to changes in classification of certain financial assets held by the Credit Union as shown in the table above:

- a) Reclassification from retired categories with no change in measurement.

The following debt instruments have been reclassified to new categories under IFRS 9, as their previous categories under IAS 39 were ‘retired’, with no change to their measurement basis:

- i) those previously classified as available for sale and now classified and measured at FVOCI; and
- ii) those previously classified as held to maturity and now classified and measured at amortized cost.

- b) Reclassification of financial assets from amortized cost to FVTPL

Loans and receivables of \$140,311 were reclassified from amortized cost under IAS 39 to FVTPL under IFRS 9 as they did not meet the requirements of solely payments and interest (SPPI). Further information on the SPPI requirements can be found in note 4.

- c) Reconciliation of impairment allowance from IAS 39 to IFRS 9

The following table reconciles the prior period’s closing impairment allowance measured in accordance with the IAS 39 incurred loss model to the new impairment allowance measured in accordance with the IFRS 9 expected loss model at January 1, 2018:

Measurement category	Loan loss allowance under IAS 39/Provision under IAS 37	Remeasurement	Loan loss allowance under IFRS 9
Loans and receivables (IAS 39)/ Financial assets at amortized cost (IFRS 9)	3,446	1,361	4,807

Further information on the measurement of the impairment allowance under IFRS 9 can be found in note 4.

IFRS 15 – Revenue from Contracts with Customers

IFRS 15 was issued in May 2014 and replaces IAS 18 – Revenue, IAS 11 – Construction Contracts and related International Financial Reporting Interpretations Committee (IFRIC) rulings. The standard was issued as a result of an ongoing project to align revenue recognition between IFRS and U.S. Generally Accepted Accounting Principles. The standard provides a single, principles-based five-step model to be applied to all contracts with customers, and also introduces additional disclosure requirements. The standard has been adopted by the Credit Union on January 1, 2018 except where the scope exceptions have been met, which excludes financial instruments within the scope of IFRS 9. Based on the Credit Union’s assessment of revenues and costs within the scope of this standard, IFRS 15 does not have a material impact on its consolidated financial results. The disclosures for revenue can be found in note 19.

Prospera Credit Union

Notes to Consolidated Financial Statements

December 31, 2018

(expressed in thousands of dollars)

IFRS 7 – Financial Instruments: Disclosures

IFRS 7 was amended in December 2011 to require additional financial instrument disclosures upon transition from IAS 39 – Financial Instruments: Recognition and Measurement (IAS 39) to IFRS 9 – Financial Instruments (IFRS 9) which was effective for annual periods beginning on or after January 1, 2018. The amendments are effective on adoption of IFRS 9. The Credit Union has incorporated extensive additional disclosure as part of the transition to IFRS9 throughout the consolidated financial statements.

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).

Prospera Credit Union

Notes to Consolidated Financial Statements

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(expressed in thousands of dollars)

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

The Credit Union has applied IFRS 9 effective January 1, 2018 and classifies its financial assets in the following measurement categories: FVTPL, FVOCI, or amortized cost. 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.

The accounting policies from January 1, 2018 under IFRS 9 related to these financial assets and liabilities are as follows:

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 trade date, the date of which Credit Union commits to purchase or sell the asset.

Prospera Credit Union

Notes to Consolidated Financial Statements

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(expressed in thousands of dollars)

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.

Financial assets

Classification and subsequent measurement

The Credit Union has applied IFRS 9 and 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:

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

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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 3. Interest income from these financial assets is included in “Interest income from loans and receivables measured at amortized cost” 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 statement of net income and comprehensive income within Other income in the period in which it arises. Interest income from these financial assets is included in “Interest income from financial instruments measured at FVTPL.” Interest income was calculated using the customer coupon rate.
- **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 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.

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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.

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.

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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 24 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;
- 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.

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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.

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.

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Prior to January 1, 2018 and the adoption of IFRS 9, the Credit Union measured and categorized its financial assets and liabilities under IAS 39:

i) Financial assets

Management determines the categorization of its financial assets at initial recognition. The Credit Union initially recognizes loans and receivables and deposits on the date that they are originated. All other financial assets, including assets designated at FVTPL, are recognized initially on the trade date at which the Credit Union becomes a party to the contractual provisions of the instrument. The Credit Union's financial assets are categorized as one of the following: financial assets at FVTPL, loans and receivables, financial assets available-for-sale (AFS) and financial assets held-to-maturity (HTM).

Financial assets at FVTPL

This category comprises financial assets classified as FVTPL and financial assets designated by the Credit Union as FVTPL upon initial recognition.

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

The Credit Union has not designated any assets as FVTPL. The Credit Union's financial assets classified as FVTPL consist of derivative financial instruments such as equity options and interest rate swaps related to securitized loans and index-linked deposit contracts.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than:

- 1) those that the Credit Union intends to sell immediately or in the short term, which are classified as FVTPL, and those that the Credit Union upon initial recognition designates as FVTPL;
- 2) those that the Credit Union upon initial recognition designates as AFS; or
- 3) those for which the holder may not recover substantially all of its initial investment, for reasons other than credit deterioration.

Loans and receivables are recorded at fair value on initial recognition and subsequently at amortized cost using the effective interest method.

The Credit Union's loans and receivables principally consist of cash and cash equivalents, loans, interest bearing deposits, and other assets.

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Financial assets available-for-sale

AFS assets are those non-derivative financial assets that are designated as AFS or are not classified as FVTPL, not designated as FVTPL or do not qualify as loans and receivables. AFS assets are recorded at cost which includes direct and incremental transaction costs. Subsequently, they are carried at fair value, unless they do not have a quoted market price in an active market and fair value is not reliably determinable, in which case they are carried at cost.

Unrealized gains and losses arising from changes in the fair value of AFS financial assets are recognized directly in equity, until the financial asset is derecognized or impaired. As a result of the derecognition or impairment of an AFS asset, the cumulative gain or loss previously recognized in equity is recognized in the consolidated statement of income.

Interest income on AFS assets is calculated using the effective interest method and is recognized in the consolidated statement of income. Dividends on AFS equity instruments are recognized in the consolidated statement of income when the Credit Union's right to receive payment is established.

The Credit Union's AFS assets consist of Central 1 equity shares and other investments, included in investments.

Financial assets held-to-maturity

HTM assets are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Credit Union's management has the positive intention and ability to hold to maturity, other than:

- 1) those that the Credit Union upon initial recognition designates as FVTPL;
- 2) those that the Credit Union designates as AFS; and
- 3) those that meet the definition of loans and receivables.

These are initially recognized at fair value including direct and incremental transaction costs and measured subsequently at amortized cost, using the effective interest method. Interest on HTM assets is recognized in the consolidated statement of income.

The Credit Union's HTM assets consist of government backed securities, which are included in investments.

ii) Financial liabilities

Management determines the categorization of its financial liabilities at initial recognition. The Credit Union initially recognizes financial liabilities (including liabilities designated at FVTPL) on the trade date at which the Credit Union becomes a party to the contractual provisions of the instrument. Financial liabilities are categorized as FVTPL or financial liabilities at amortized cost. Financial liabilities are derecognized when extinguished.

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Financial liabilities at FVTPL

Upon initial recognition, financial liabilities at FVTPL are classified or are designated by the Credit Union as 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 borrowings were recorded at amortized cost.

Financial liabilities at amortized cost

Financial liabilities that are not classified or designated as FVTPL fall into this category. Financial liabilities at amortized cost consist of amounts drawn on lines of credit, accounts payable, certain secured borrowings, and deposits. These are measured at fair value on initial recognition and subsequently at amortized cost using the effective interest method.

iii) Fair value of financial instruments

The best evidence of fair value at initial recognition is prices quoted in an active market. Fair values of financial instruments quoted in active markets are determined by reference to closing bid prices at the reporting date. If there is no active market for a financial instrument, the Credit Union establishes fair value using an appropriate valuation technique. These techniques principally include the use of recent arm's length transactions for investments in unquoted securities, discounted cash flow analysis for derivatives, third-party option pricing models for index-linked option contracts and other valuation techniques commonly used by market participants.

Fair values reflect the credit risk of the instruments and include adjustments to take account of the credit risk of the Credit Union and the counterparty as relevant. Fair value estimates obtained from models are adjusted for other factors, such as liquidity risk or model uncertainties, to the extent that the Credit Union believes a third-party market participant would take them into account in pricing a transaction. Fair values determined by applying valuation techniques utilize independent observable market inputs to the maximum extent possible.

iv) Impairment of financial assets

The Credit Union assesses, at each statement of financial position date, whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are recorded only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a loss event) and the loss event has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

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Objective evidence that financial assets are impaired can include significant financial difficulty of the borrower or issuer, default or delinquency by a borrower, restructuring of a loan or advance by the Credit Union on non-market terms that the Credit Union would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, or other observable data relating to a group of assets such as conditions that correlate with defaults in the group.

Financial assets classified as loans and receivables

The Credit Union maintains an allowance for credit losses that, in management's estimation, is considered adequate to provide for credit-related losses. The allowance for credit losses consists of individual and collective allowances. The individual allowance is determined on the basis of specific loans that, in management's opinion, may not be fully collectible. The individual allowance is the amount required to reduce the carrying value of an impaired loan to its present value of estimated future cash flows discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment is the current effective interest rate determined under the contract at the time the loan becomes impaired.

For the purposes of a collective evaluation of impairment, the portfolio is grouped on the basis of similar characteristics. These characteristics are relevant to the estimation of future cash flows and historical loss experience which is adjusted on the basis of current observable data to reflect the effects of current conditions. Assets that are individually assessed for impairment and for which no individual allowances are recorded are included in a collective assessment of impairment.

The Credit Union adjusts its input to its collective allowance methodology on an ongoing basis, taking into account factors such as historical loss experience and adjusting for current observable data that did not impact the period which the historical loss experience was based on. Estimates of changes in future cash flows for groups of assets reflect and are directionally consistent with changes in related observable data from period to period (for example, mortgage delinquency, or other factors indicative of changes in the probability of losses by the Credit Union and in their magnitude).

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognized in the consolidated statement of income in provision for credit losses.

Loans that were past due and whose terms have been renegotiated are no longer considered to be past due but are treated as new loans.

The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Credit Union, as and when more information becomes available, to reduce any differences between loss estimates and actual loss experience. When a loan is uncollectible, it is written off after the amount of the final loss has been determined.

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Assets classified as available-for-sale

A significant or prolonged decline in the fair value of an AFS equity security below its cost is considered objective evidence in determining whether the asset is impaired. An AFS debt instrument may be identified as impaired due to circumstances which can include actual delinquency in contractual payment of principal or interest and/or significant events which indicate there is doubt as to the collectibility of the principal or contractual interest. For designated AFS assets, if any such evidence exists, the cumulative loss, measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in the consolidated statement of income, is reclassified from equity and recognized in the consolidated statement of income.

If, in a subsequent period, the fair value of a debt instrument classified as AFS increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in the consolidated statement of income, the impairment loss is reversed through the consolidated statement of income. Impairment losses recognized in the consolidated statement of income on equity instruments are not reversed.

Assets classified as held-to-maturity

A HTM debt instrument may be identified as impaired due to circumstances which can include actual delinquency in contractual payment of principal or interest and/or significant events which indicate there is doubt as to the collectibility of the principal or contractual interest. In the case of an impairment, the impairment loss is reported as a deduction from the carrying value of the investment and recognized in the consolidated statement of income.

The following policies continue to be in effect for both years ended December 31, 2017 and December 31, 2018:

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 Credit Union has not provided comparative information for periods before the date of initial application of IFRS 9 for the new disclosures introduced by IFRS 9 as permitted by IFRS 7.

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).

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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 2018 or 2017.

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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.

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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) 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.

iii) 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
Computer equipment	3 to 10 years
Office furniture	3 to 10 years
Equipment	3 to 10 years

The residual values and useful lives of premises and equipment are reviewed, and adjusted if appropriate, at each 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.

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 3 to 10 years.

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l) Leased assets

In accordance with IAS 17 – Leases, 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.

All of the Credit Union's lease agreements are 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.

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.

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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.

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.

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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.

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 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 16(h).

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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:

- 1) has control or joint control over the Credit Union, with the power to govern the Credit Union's financial and operating policies;
- 2) has significant influence over the Credit Union, participating in financial or operating policy decisions, but not control over these policies; or
- 3) 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:

- 1) 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);
- 2) 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);
- 3) both entities are joint ventures of the same third party;
- 4) one entity is a joint venture of a third entity and the other entity is an associate of the third entity;
- 5) 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;
- 6) the entity is controlled or jointly controlled by a person identified in (i) above; or
- 7) 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).

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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.

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.

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- 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. Those expected to have an effect on the Credit Union's consolidated financial statements are discussed below:

- i) IFRS 16 – Leases

IFRS 16 was issued in January 2016 and is intended to replace IAS 17 – Leases, and related IFRICs. The standard provides a single lessee accounting model, requiring lessees to recognize right of use assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. The standard is effective for annual periods beginning on or after January 1, 2019. Management expects that the operating leases that are disclosed in note 23 will result in a right of use asset and liability. The Credit Union is currently evaluating the quantitative impact that this standard will have on its 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

From January 1, 2018 upon transition to IFRS 9:

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 24, which also sets out key sensitivities of the ECL to changes in these elements.

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

- 1) determining criteria for significant increase in credit risk (SICR);
- 2) choosing appropriate models and assumptions for the measurement of ECL;
- 3) establishing the number and relative weightings of forward-looking scenarios for each type of product and the associated ECL; and
- 4) establishing groups of similar financial assets for the purposes of measuring ECL.

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Prior to January 1, 2018, the methodology for estimates for allowance for credit losses was as follows:

The Credit Union regularly reviews its loan portfolio for impairment. In determining whether an impairment loss should be recorded in the consolidated statement of income, the Credit Union makes judgments as to whether there is any observable data indicating an impairment trigger followed by a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified within that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of members in a group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows.

Management also uses estimates for the consideration of key variables within the loan loss allowance methodology, including the probabilities of future member defaults considering historic trends, the estimated loss identification period between impairment occurring and losses being identified and evidenced by the establishment of an appropriate allowance, and also the incorporation of a qualitative adjustment for management's judgment as to whether current economic conditions that exist at the reporting date (but which are not present in the data sets used to establish the various metrics underlying the loan loss) could cause the actual level of inherent losses to be greater or less than those suggested by historic experience.

The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed annually to reduce any difference between loss estimates and actual loss experience. Were the net present value of estimated cash flows to differ by +/-1%, the impairment loss is estimated to be \$67 higher or lower. The Credit Union has disclosed the allowance for credit losses on loans in note 7.

b) Classification and measurement

From January 1, 2018 upon transition to IFRS 9:

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.

c) 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.

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Included in the results reported for the year ended December 31, 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 6. This portfolio was classified and measured at fair value at initial acquisition on November 30, 2017 and classified as amortized cost at December 31, 2017 under IAS39. Effective January 1, 2018, upon transition to IFRS 9, this portfolio was reclassified as fair value based on the cash flow characteristics of the asset.

The Credit Union has disclosed the fair values of financial instruments in note 27.

d) 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 16.

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.

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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 22.

6 Crelogix

Prior to July 6, 2017, the Credit Union, among other funders, had a long standing relationship with a third party consumer loan origination firm, Crelogix Acceptance Corporation (Crelogix), whereby the Credit Union would purchase receivables in the form of a stream of cashflows related to personal loans originated by Crelogix. Although this arrangement was considered a legal purchase, for the purposes of IFRS reporting, it did not qualify for purchase/sale treatment due to the retention of risk by Crelogix. Therefore, from the Credit Union's perspective, this arrangement under IFRS was considered a secured loan. On July 6, 2017, Crelogix was placed into receivership, as directed by the court, as it was no longer able to fulfill its cash flow obligations. Alvarez and Marsal were appointed as the Receiver to gain control of the operations over the receivership process, to preserve and protect all of Crelogix' assets and to allocate any residual resources to the appropriate creditor. As at December 31, 2017, the Credit Union has recognized an amount owing for loan payments received through October 31, 2017 of \$3,897, which is included in Other Assets (note 11).

Over the course of the receivership period, the Credit Union negotiated an Asset Purchase Agreement with the Receiver and entered into a transition and servicing agreement with a third party to assume control of the operations and collection of the receivables, to ensure effective collection going forward. Pursuant to an Asset Purchase Agreement effective November 30, 2017, the Credit Union acquired substantially all of the assets of Crelogix that the Credit Union did not already legally own. The nature of the set of assets acquired was assessed as providing the ability to the Credit Union to conduct it as a business. Accordingly, IFRS 3 – Business Combinations applies to the accounting for the acquisition.

The Credit Union completed the purchase transaction in 2017 for cash consideration of \$535 after taxes which was allocated in full at fair value to Property, Premises and Equipment of \$360 (note 10) and Intangible Software of \$175 (note 12). No goodwill was identified in the purchase price allocation. The Credit Union incurred legal, professional and receivership costs of \$1,208 associated with the analysis and transition of the portfolio along with execution of the Asset Purchase Agreement. These costs are recorded within Administration and Other expenses (note 21) within the Consolidated Statement of Income and Comprehensive Income.

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Prior to receivership, as part of the original agreement, Crelogix provided all administration and collection services associated with the loans receivable. These processes were assumed over the receivership period by the Receiver. On November 30, 2017, at the close of the receivership period, the Credit Union exercised the right to collect on the loans directly.

As part of the Asset Purchase Agreement, the Credit Union assumed ownership and control of the bank accounts that are used for clearing of payments for all Crelogix originated loans, including those previously purchased by other funders. Accordingly, the Credit Union controls the primary clearing functions associated with monthly administration and payments for all funders. Within Other Liabilities on the Consolidated Statement of Financial Position is \$1,039 of Accounts Payable to funders (note 17) which represents the amount owing to other funders for payments collected through the bank account owned by the Credit Union as at December 31, 2017.

Included in Loans on the Consolidated Statement of Financial Position and within the Personal Banking Loans segment (note 7) is the Crelogix loan portfolio of \$98,349 (2017 – \$140,311). The Crelogix loan portfolio is classified as loans and receivables on the Consolidated Statement of Financial Position and accounted for at amortized cost at December 31, 2017. Details on the 2017 balances are as follows:

Crelogix loan

	\$
Opening Balance – January 1, 2016	148,159
New loan purchase made during the year	82,744
Paydowns made during the year	<u>(55,864)</u>
Balance – December 31, 2016	175,039
New loan purchases made during the year	33,224
Paydowns made during the year	(57,427)
Provisions released to Crelogix impairment on derecognition	(600)
Increase to full contractual payment value	5,552
Impairment on derecognition of Crelogix	<u>(13,446)</u>
Balance – November 30, 2017	<u>142,342</u>

Crelogix portfolio

	\$
Recognition at fair value – November 30, 2017	142,342
December payments received	<u>(2,031)</u>
Balance – December 31, 2017	<u>140,311</u>

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Following the receivership period, the Credit Union exercised its right to collect on the loans directly. On November 30, 2017, the Credit Union derecognized the loans receivable from Crelogix and determined the fair value of the collateral received or rights to direct receivership from the individual borrowers. The Credit Union recognized an impairment loss on financial assets in the Consolidated Statement of Income and Comprehensive Income of \$7,493 as part of this valuation.

IAS 39 requires that the consideration received to settle the Crelogix loan receivable must be recognized at fair value. The fair value of the portfolio was calculated by the Credit Union using a valuation model that considers the present value of the net cash flows to be generated from the loan portfolio, taking into account expected probability of default and prepayment and loss given default that is not already reflected in the discount rate used. The expected net cash flows were increased to reflect the full contractual payment value due to the Credit Union upon seizure of the right to collect and discounted using risk-adjusted discount rates that consider risk factors present at the time of origination with incremental default and prepayment risk factors assessed separately to produce a fully risk-adjusted discounted cash flow. The incremental risk factors are due to the loans now being uncollateralized and with the individual borrowers. Previously, the loan with Crelogix included collateral in the form of a reserve account which had a nil balance at the time of derecognition (2016 – \$5,635) as well as indemnification of prepayment risk.

The principal assumptions used to calculate the fair value of the Crelogix loans at November 30, 2017 are as follows:

Assumption

Partially risk adjusted weighted average discount rate	6.78%
Incremental probability of defaults based on loan vintage	0.50% to 2.84%
Loss given default	74%
Incremental probability of prepayments depending on loan vintage	1.50% to 17.03%

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.

Partially risk adjusted weighted average discount rate	1% increase (decrease)	+/- \$4,809
Incremental probability of defaults based on loan vintage	0.5% increase (decrease)	+/- \$2,447
Loss given default	10% increase (decrease)	+/- \$772
Incremental probability of prepayments depending on loan vintage	5% increase (decrease)	+/- \$2,536

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Effective January 1, 2018 upon transition to IFRS9 the Crelogix loan portfolio was reclassified as FVTPL based on the cash flow characteristics of the asset (note 3) but no remeasurement was required as amortized cost was determined to approximate fair value at January 1, 2018.

Crelogix portfolio

	\$
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

The fair value of the portfolio at December 31, 2018 was 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.

This valuation technique is similar to the method applied upon original acquisition with refinements in the approach to reflect the maturity of information (or additional information made available) over the period.

The principal assumptions used to calculate the fair value of the Crelogix loans at December 31, 2018 are as follows:

Assumption

Risk free rate	2.40%
Portfolio specific spread	4.44%
Probability of defaults based on loan vintage	0.0% to 2.30%
Loss given default	100.00%
Probability of prepayments depending on loan vintage	0.05% to 6.84%

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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.

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

7 Loans

The following table represents the loan balances and the allowance for credit losses as at December 31, 2017 under IAS 39 with comparatives for December 31, 2018 under IFRS 9:

	2018	2017
	\$	\$
Personal Banking		
Residential mortgages (note 8)	1,991,149	1,831,506
Loans – measured at amortized cost	235,766	222,504
Loans – measured at fair value	96,299	140,311
Business Banking mortgages and loans	857,313	777,102
Net deferred transaction fees and related costs	2,776	2,566
Accrued interest	5,291	4,371
	<hr/>	<hr/>
	3,188,594	2,978,360
Less: Allowance for credit losses	(4,834)	(3,446)
	<hr/>	<hr/>
	3,183,760	2,974,914
	<hr/>	<hr/>
Current	1,093,443	1,072,331
Non-current	2,090,317	1,902,583

At December 31, 2018, loans measured at amortized cost are presented net of allowances for expected credit losses totalling \$4,834.

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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.

				2018
	Stage 1 12-month ECL \$'000	Stage 2 Lifetime ECL \$'000	Stage 3 Lifetime ECL \$'000	Total \$'000
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:

- 1) 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;
- 2) additional allowances for new financial instruments recognized during the period, as well as releases for financial instruments derecognized in the period;
- 3) 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;
- 4) impacts on the measurement of ECL due to changes made to models and assumptions;
- 5) 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 24.

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Reconciliation of allowance for credit losses

	2018 \$	2017 \$
Balance – Beginning of year	3,446	4,046
January 1, 2018 IFRS 9 transition adjustment (note 2)	1,361	-
Loan write-offs (note 24)	(169)	(256)
Provision for credit losses	196	256
Provision released to Crelogix impairment (note 6)	-	(600)
	<hr/>	<hr/>
Balance – End of year	4,834	3,446

During the year, the Credit Union recorded recoveries of \$46 (2017 – \$100) on loans that have been previously written off. Such recoveries are included within provision for credit losses in the consolidated statement of income.

At December 31, 2017, the total allowance for credit losses of \$3,446 was made up of an individual allowance of \$636 and a collective allowance of \$2,810.

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.

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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, 2018 or December 31, 2017.

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.

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 \$146,880 (2017 – \$94,332) 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, 2018, the Credit Union had \$384,818 (2017 – \$324,971) 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, 2018 was \$571,523 (2017 – \$481,367) 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 24.

Prospera Credit Union
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(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	
	2018	2017
	\$	\$
Carrying amount of assets	515,846	433,484
Carrying amount of associated liabilities	(520,103)	(438,151)
Carrying amount of derivatives	(5)	5
For those liabilities that have recourse only to the transferred assets:		
Fair value of assets	519,907	437,532
Fair value of associated liabilities	(520,103)	(438,151)
Fair value of associated derivatives	(5)	5
Net position	(4,463)	(5,276)

Transferred financial assets that are derecognized

During 2015, the Credit Union entered into a whole loan sale agreement with Central 1 to sell a pool of \$19,772 CMHC insured mortgages. 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 \$31 (2017 – \$53) in servicing revenues that was recorded in Other Income. Cumulatively, as of December 31, 2018 the Credit Union has received \$238 in servicing revenues from the continuing involvement in these assets (2017 – \$207). 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 \$12 (2017 – \$58). The following table describes the mortgages to be collected by the Credit Union on behalf of Central 1:

2018

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

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2017

Type of continuing involvement	Total \$	Maturity of continuing involvement					
		Within 3 months \$	3-6 months \$	6 months - 1 year \$	1-3 years \$	3-5 years \$	More than 5 years \$
Securitized loans	13,611	-	-	-	13,611	-	-

9 Investments

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

	2018 \$	2017 \$
Central 1 equity shares	15,894	14,509
Government backed securities	6,541	6,357
Government backed securities – reinvestment account (note 13)	131,028	108,513
Other investments	6,250	11,578
	<u>159,713</u>	<u>140,957</u>
Current portion	47,892	42,483
Non-current portion	111,821	98,474

Included in Central 1 equity shares are 63,324 (2017 – 84,376) 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. During the year ended December 31, 2017, Central 1 redeemed 4,211 of the Class E shares at the stated redemption value of \$100. The Credit Union received proceeds and recorded a gain on this redemption of \$421 within investment income. In December 2017, Central 1 confirmed the intention to redeem another 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 redeem 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.

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(expressed in thousands of dollars)

	2018 \$	2017 \$
Central 1 A shares	1,385	11,904
Central 1 F shares	14,508	-
Central 1 E shares at cost	1	1
Central 1 E shares at redemption value	-	2,105
Accrued dividends	-	499
	<hr/>	<hr/>
Total Central 1 equity shares and accrued dividends	15,894	14,509

10 Property, premises and equipment

	Office equipment \$	Office furniture \$	Leasehold improvements \$	Land and buildings \$	Automotive equipment \$	Total \$
Cost						
As at December 31, 2016	12,584	1,744	11,134	1,411	40	26,913
Additions	1,892	387	58	-	-	2,337
Disposals	(2,109)	(188)	(4)	-	-	(2,301)
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
As at December 31, 2017	12,367	1,943	11,188	1,411	40	26,949
Additions	1,126	34	620	18	-	1,798
Disposals	(1,158)	(14)	-	(9)	-	(1,181)
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
As at December 31, 2018	12,335	1,963	11,808	1,420	40	27,566
Depreciation and impairment						
As at December 31, 2016	8,690	1,575	9,055	92	6	19,418
Disposals	(2,108)	(188)	(4)	-	-	(2,300)
Depreciation charge for the year	1,123	51	475	44	4	1,697
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
As at December 31, 2017	7,705	1,438	9,526	136	10	18,815
Disposals	(1,153)	(14)	-	(3)	-	(1,170)
Depreciation charge for the year	1,285	91	357	44	4	1,781
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
As at December 31, 2018	7,837	1,515	9,883	177	14	19,426
Carrying amounts						
As at December 31, 2017	4,662	505	1,662	1,275	30	8,134
As at December 31, 2018	4,498	448	1,925	1,243	26	8,140

11 Other assets

	2018 \$	2017 \$
Prepaid expenses	4,473	3,652
Other receivable (note 6)	-	3,897
Accounts receivable	2,665	1,986
	<hr/>	<hr/>
	7,138	9,535
	<hr/>	<hr/>
Current portion	4,399	7,362
Non-current portion	2,739	2,173

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(expressed in thousands of dollars)

12 Intangibles

	Software
	\$
Cost	
As at December 31, 2016	10,083
Additions	404
Disposals	(163)
	<hr/>
As at December 31, 2017	10,324
Additions	133
Disposals	(6)
	<hr/>
As at December 31, 2018	<hr/> <u>10,451</u>
Amortization	
As at December 31, 2016	8,388
Disposals	(163)
Amortization charge for the year	599
	<hr/>
As at December 31, 2017	8,824
Disposals	(6)
Amortization charge for the year	589
	<hr/>
As at December 31, 2018	<hr/> <u>9,407</u>
Carrying amounts	
As at December 31, 2017	1,500
As at December 31, 2018	1,044

Remaining amortization of the carrying amounts as at December 31, 2018 is as follows:

	\$
Within 1 year	521
1 – 5 years	523
	<hr/>
	<u>1,044</u>

13 Borrowings

	2018	2017
	\$	\$
Subordinated debt	15,000	15,000
Lines of credit	44,891	28,533
Secured borrowings (note 8)		
At amortized cost	473,146	354,441
At fair value	48,468	84,800
	<hr/>	<hr/>
	<u>581,505</u>	<u>482,774</u>

Prospera Credit Union

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(expressed in thousands of dollars)

Maturity date	Weighted average interest rate %	2018 \$	2017 \$
Due in 2018	1.69	-	67,746
Due in 2019	0.61	106,477	68,202
Due in 2020	1.28	53,056	56,870
Due in 2021	1.42	253,403	227,385
Due in 2022	2.21	89,014	47,464
Due in 2023	2.32	64,555	-
Due in 2027	7.15	15,000	15,000
Fair value adjustment		-	107
		<u>581,505</u>	<u>482,774</u>
Current		106,477	67,746
Non-current		475,028	415,028

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 5 years at the Credit Union's option. The subordinated debt qualifies as Tier 2 secondary capital for regulatory capital purposes and has an interest rate of 7.15%.

During the year ended December 31, 2017, the Credit Union entered into a new line of credit facility agreement with Desjardins for \$55,000. As of December 31, 2018, the Credit Union has approved lines of credit totalling \$270,725 (2017 – \$270,508).

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, 2018 and December 31, 2017, 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 \$384,818 (2017 – \$324,971) and government backed securities of \$131,028 (2017 – \$108,513) (notes 8 and 9).

14 Deposits

	2018 \$	2017 \$
Term deposits	1,746,573	1,611,283
Demand deposits	817,624	842,046
Registered savings plans	471,930	432,220
Member deposit shares (note 15(b))	3,827	3,911
Deferred transaction costs	(231)	(402)
Accrued interest	20,926	15,405
	<u>3,060,649</u>	<u>2,904,463</u>
Current	2,451,382	2,175,683
Non-current	609,267	728,780

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(expressed in thousands of dollars)

15 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 14) consist of the following:

(expressed in thousands of dollars except for number of shares)

	2018 \$	2017 \$
3,827,235 (2017 – 3,878,809) Class A Membership equity shares	3,827	3,879
Nil (2017 – 32,052) Class D Non-equity shares	-	32
	<hr/> 3,827	<hr/> 3,911
	<hr/> 2018 \$	<hr/> 2017 \$
Class A Membership equity shares issued in the year	204	193
Class A Membership equity shares redeemed in the year	(255)	(286)
	<hr/> (51)	<hr/> (93)

The Class D Non-equity shares were subject to full redemption in 2018. No new Class D Non-equity shares were issued during 2018 (2017 – nil).

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(expressed in thousands of dollars)

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

	2018 \$	2017 \$
3,058,878 (2017 – 3,212,904) Class C Investment equity shares	3,059	3,213

The changes in Class C Investment equity shares relate to redemptions only as no shares were issued during the year (2017 – nil).

16 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:

	2018		2017	
	Funded plans	Unfunded plans		
Weighted average duration	18 years	6 years	17 years	18 years

The unfunded portion of the defined benefit obligation is \$1,680 (2017 – \$1,985). 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 \$991 (2017 – \$1,157).

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(expressed in thousands of dollars)

a) Retirement benefit obligation

			2018	2017
	Funded plans \$	Unfunded plans \$	Total \$	Total \$
Defined benefit obligation	(29,666)	(1,740)	(31,406)	(32,501)
Fair value of plan assets	24,359	60	24,419	23,363
Net retirement benefit obligation	<u>(5,307)</u>	<u>(1,680)</u>	<u>(6,987)</u>	<u>(9,138)</u>
Retirement benefit asset recognized on the consolidated statement of financial position	539	-	539	583
Retirement benefit obligation recognized on the consolidated statement of financial position	<u>(5,846)</u>	<u>(1,680)</u>	<u>(7,526)</u>	<u>(9,721)</u>
Net retirement benefit obligation	<u>(5,307)</u>	<u>(1,680)</u>	<u>(6,987)</u>	<u>(9,138)</u>
Current portion	(960)	(311)	(1,271)	(1,151)
Non-current portion	(4,347)	(1,369)	(5,716)	(7,987)

The movement in the defined benefit obligation is as follows:

			2018	2017
	Funded plans \$	Unfunded plans \$	Total \$	Total \$
Defined benefit obligation at January 1	30,459	2,042	32,501	29,590
Current service cost (net of employee contributions)	801	35	836	747
Interest cost	1,072	67	1,139	1,189
Remeasurements – experience	13	253	266	(289)
Remeasurements – demographic	-	(73)	(73)	-
Remeasurements – financial	(1,400)	(39)	(1,439)	2,511
Benefit payments	(1,279)	(309)	(1,588)	(1,247)
Past service costs	-	(236)	(236)	-
Defined benefit obligation at December 31	<u>29,666</u>	<u>1,740</u>	<u>31,406</u>	<u>32,501</u>

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(expressed in thousands of dollars)

b) Fair value of plan assets

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

			2018	2017
	Funded plans \$	Unfunded plans \$	Total \$	Total \$
Fair value of plan assets at January 1	23,305	58	23,363	21,940
Interest income	812	-	812	879
Administration expenses	(71)	-	(71)	(69)
Remeasurements – financial	501	-	501	397
Employer contributions	1,091	311	1,402	1,463
Benefit payments	(1,279)	(309)	(1,588)	(1,247)
Fair value of plan assets at December 31	24,359	60	24,419	23,363

ii) Funded plan assets comprise the following:

	Funded defined benefit plans	
	2018 %	2017 %
Asset category		
Equity securities	46	47
Debt instruments	27	29
Real estate	14	13
Other assets	13	11
	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, 2018. The effective date of the last actuarial valuation reports for funding purposes was December 31, 2015 and the effective date of the next required actuarial valuation report for funding purposes will be December 31, 2018.

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(expressed in thousands of dollars)

The December 31, 2015 actuarial valuations for the funded plans indicated a going concern unfunded liability of \$788 and a solvency deficiency of \$4,191. This deficit is targeted to be financed over time through increased contributions. 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 2025. The Credit Union paid \$1,091 (2017 – \$1,115) for employer contributions to the funded plans in fiscal year 2018. As a result of the valuation, the employer contribution rates were determined to be a flat dollar amount of \$600 per annum effective January 1, 2017 rather than a percentage of payroll. Prior to January 1, 2017, the employer contribution rates were 14.0% – 22.4% per annum depending on the plan holder’s age, based on the pensionable earnings of the respective participating employees, which is a combined contribution rate covering current service costs and solvency deficit funding.

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 includes investments in long bonds while the return enhancing investments includes 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, 2018 was \$1,312 (2017 – \$1,276).

c) Future contributions and benefit payments

The expected contributions and benefit payments for the year ending December 31, 2019 are as follows:

	\$
Employer contributions	1,404
Employee benefits	(1,272)

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(expressed in thousands of dollars)

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

	2018	2017
	\$	\$
Current service cost (net of employee contributions)	836	747
Interest cost	1,139	1,189
Administration costs	71	69
Past service cost	(236)	-
Interest income	(812)	(879)
	<hr/>	<hr/>
Total included in employee benefits expense (note 20)	998	1,126
	<hr/>	<hr/>

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

	2018	2017
	\$	\$
Remeasurements in the year	1,747	(1,825)
Income tax (recovery)	(297)	79
	<hr/>	<hr/>
Other comprehensive income (loss) related to defined benefit plans for the year	1,450	(1,746)
	<hr/>	<hr/>

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

	2018	2017
	%	%
Discount rate	3.82	3.50
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:

	2018	2017
	%	%
Health care cost		
Extended health	7.00	7.50
MSP	-	4.00
Dental	4.50	3.00

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

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December 31, 2018

(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 (2017 – 22 years) and females to 24 years (2017 – 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.

	2018 \$	2017 \$
Discount rate		
Impact of: 1% increase	(4,753)	(4,979)
1% decrease	6,073	6,490
Inflation rate		
Impact of: 1% increase	1,470	1,450
1% decrease	(1,346)	(1,443)
Future salary increases		
Impact of: 1% increase	1,431	1,307
1% decrease	(1,218)	(1,226)
Medical/dental trends		
Impact of: 1% increase	76	80
1% decrease	(65)	(70)

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.

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(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, 2018 are estimated at \$729,403 (2017 – \$714,731). 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, 2015, indicated a going concern unfunded liability of \$25,078 and a solvency deficiency of \$123,032. 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 2025. The Credit Union paid \$2,557 (2017 – \$2,342) for employer contributions to the Plan in fiscal year 2018. 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, 2017. The contributions continue to be expensed as invoiced by the Plan. The next actuarial valuation is scheduled for December 31, 2018.

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(expressed in thousands of dollars)

17 Other liabilities

	2018	2017
	\$	\$
Accounts payable and accruals	5,263	7,709
Accounts payable to funders (note 6)	1,039	2,800
Deferred revenue	44	552
	<u>6,346</u>	<u>11,061</u>
Current	6,208	10,838
Non-current	138	223

18 Net interest income

	2018
	\$
Interest income and dividend income	
Financial instruments measured at amortized cost using the effective interest method	
Cash and cash equivalents	151
Interest bearing deposits	5,951
Investments	2,046
Loans and receivables	102,672
Financial instruments measured at FVTPL	
Loans and receivables	11,531
Derivatives	82
Financial instruments measured at FVOCI using the effective interest method	
Investments	238
Cash flow hedges	(143)
	<u>122,528</u>
Interest expense	
Financial instruments measured at amortized cost	
Deposits	44,517
Borrowings	
Lines of credit	2,507
Subordinated debt	1,007
Secured borrowings	6,303
Financial instruments measured at FVTPL	
Secured borrowings	1,141
	<u>55,475</u>
Net interest income	<u>67,053</u>

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(expressed in thousands of dollars)

	2017
	\$
Interest income	
Cash and cash equivalents	31
Interest bearing deposits	8,590
Financial assets	
Cash flow hedges	(115)
Fair value through profit or loss	(626)
Available for sale investments	278
Held-to-maturity investments	1,358
Loans	93,455
	<hr/>
	102,971
Interest expense	
Deposits	33,960
Borrowings	
Lines of credit	1,236
Subordinated debt	476
Secured borrowings	4,624
	<hr/>
	40,296
	<hr/>
Net interest income	62,675

19 Other income

	2018	2017
	\$	\$
Investment management	6,389	6,133
Service charges	4,948	4,658
Insurance commissions	859	952
Loan fees	712	776
Foreign exchange	639	635
Contract renewal fee	500	1,500
Other	163	50
Net gain on sale of investments	-	126
Net gain (loss) on change in fair value measurement (note 6)	(15,381)	-
	<hr/>	
	(1,171)	14,830
	<hr/>	

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20 Salaries and employee benefits

	2018 \$	2017 \$
Salaries	25,915	27,103
Benefits		
Other	3,103	3,081
Post-employment defined benefit plans	(237)	59
Pension costs		
Defined contribution plans including multi-employer plan	2,638	2,435
Defined benefit plans	1,235	1,067
	<hr/> 32,654	<hr/> 33,745

21 Other expenses

	2018 \$	2017 \$
Deposit insurance fees	2,714	2,353
Loan administration fees	1,753	665
Professional services	1,299	1,086
Other	501	449
Central 1 dues	377	388
Loss on sale of property, premises and equipment	42	7
	<hr/> 6,686	<hr/> 4,948

22 Income taxes

	2018 \$	2017 \$
Current tax expense	521	1,251
Deferred tax expense	(76)	554
	<hr/> 445	<hr/> 1,805

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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% (2017 – of 26%) to income before income taxes. The reasons for the differences are as follows:

	2018	2017
	\$	\$
Computed tax expense	543	2,236
(Decrease) increase resulting from		
Preferred rate amount deduction for credit unions	(201)	(764)
Non-taxable items	33	46
Effect of tax rate changes on deferred income tax asset	(1)	330
Other	71	(43)
	<u>445</u>	<u>1,805</u>

The effective tax rate for the Credit Union, net of the credit union deduction was 17.00% (2017 – 17.12%). The overall tax rate was 22.97% (2017 – 20.99%). 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:

	2018	2017
	\$	\$
Deferred income tax assets		
To be recovered within 12 months	408	537
To be recovered after more than 12 months	2,447	2,337
	<u>2,855</u>	<u>2,874</u>
Deferred income tax liabilities		
To be settled within 12 months	1	164
To be settled after more than 12 months	287	477
	<u>288</u>	<u>641</u>
Net deferred income tax assets	<u>2,567</u>	<u>2,233</u>

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

	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)	-	-
	<u>2,874</u>	<u>278</u>	<u>(297)</u>	<u>2,855</u>
Deferred income tax liabilities				
Prepaid loan expenses	941	(84)	-	857
Other	(300)	286	(555)	(569)
	<u>641</u>	<u>202</u>	<u>(555)</u>	<u>288</u>
Net deferred income tax assets	<u>2,233</u>	<u>76</u>	<u>258</u>	<u>2,567</u>
	December 31, 2016 \$	Recognized in profit or loss \$	Recognized in other comprehensive income \$	December 31, 2017 \$
Deferred income tax assets				
Provision for credit losses	692	(203)	-	489
Deferred revenue	411	25	-	436
Retirement benefit obligation and severance accruals	1,696	(223)	79	1,552
Property, premises, equipment and software intangibles – differences between carrying amounts and undepreciated capital cost	623	(329)	-	294
Loss carry-forwards	79	6	-	85
Other	345	(327)	-	18
	<u>3,846</u>	<u>(1,051)</u>	<u>79</u>	<u>2,874</u>
Deferred income tax liabilities				
Prepaid loan expenses	1,028	(87)	-	941
Other	176	(410)	(66)	(300)
	<u>1,204</u>	<u>(497)</u>	<u>(66)</u>	<u>641</u>
Net deferred income tax assets	<u>2,642</u>	<u>(554)</u>	<u>145</u>	<u>2,233</u>

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23 Commitments and contingent liabilities

Commitments

Leases

The Credit Union's premises are leased for varying terms and the majority of the leases are renewable at the end of the lease period at market rate. Lease payments included in occupancy expense amounted to \$5,659 (2017 – \$5,703). Future minimum lease commitments under non-cancellable operating leases are as follows:

	2018 \$	2017 \$
Due in < 1 year	4,825	5,682
Due in 2-5 years	13,634	14,656
Due in > 5 years	1,526	3,471
	<hr/> 19,985	<hr/> 23,809

The Credit Union has entered into non-cancellable sublease agreements of three premises leased by the Credit Union. The Credit Union expects to receive the following minimum sublease payments under these non-cancellable sublease arrangements:

	2018 \$	2017 \$
Due in < 1 year	51	52
Due in 2-5 years	-	39
	<hr/> 51	<hr/> 91

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 \$15,803 (2017 – \$14,942), which are secured by term deposits or property mortgages.

Undrawn loan commitments

Refer to note 24.

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.

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24 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.

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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

i) 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:

- 1) Target markets and product offerings are well defined at both the organizational and lines of business levels;
- 2) The risk parameters for new underwritings and for the portfolios as a whole are clearly specified; and
- 3) 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:

- 1) Key credit risk management principles;
- 2) Delegation of authority;
- 3) The credit risk management program;
- 4) Aggregate limits, beyond which credit applications must be escalated to the Board for approval; and
- 5) 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.

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- ii) 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.
- iii) 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
- iv) IFRS 9 outlines a ‘three-stage’ model for impairment based on changes in credit quality since initial recognition as summarized below:
 - 1) 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.
 - 2) If a significant increase in credit risk (SICR) since initial recognition is identified, the financial instrument is moved to ‘Stage 2’ but is not yet deemed to be credit-impaired.
 - 3) If the financial instrument is credit-impaired, the financial instrument is then moved to ‘Stage 3’.
 - 4) 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.
 - 5) A pervasive concept in measuring ECL in accordance with IFRS 9 is that it should consider forward-looking information.
 - 6) 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).

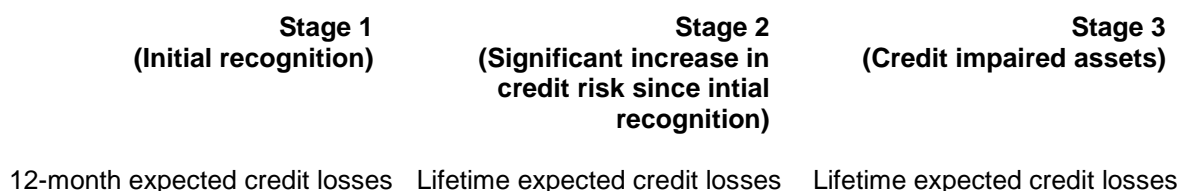
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The following diagram summarizes the impairment requirements under IFRS 9 (other than purchased or originated credit-impaired financial assets):



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:

For personal banking

- 1) Beacon scores that are available in the banking system are queried and updated on an annual basis and reviewed for deterioration. Management has determined thresholds for credit score changes that indicate a SICR:
 - i) a 100 point change of any scores above 650;
 - ii) a 50 point change of any scores below 650.
- 2) Any Personal banking loan that is currently or has been in the past 6 months more than 30 days past due.
- 3) Any Personal banking loan that is currently monitored as a result of a requirement to pay and/or family maintenance claim.

For business banking

- Any Commercial loan with a Risk Rating of 4.
- Any Commercial loan on the Watch list or Out of Order report.
- Any Commercial loan that is currently or has been in the past 6 months more than 30 days past due.
- Any Commercial loan that is currently monitored as a result of a requirement to pay and/or family maintenance claim

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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 accommodate management judgement 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 risk, 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.

Backstop

A backstop is applied and the financial instrument 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 year ended December 31, 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:

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

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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 Probability of Default, Exposure at Default, and Loss Given Default, defined as follows:

- 1) 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.
- 2) 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.
- 3) 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.

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

- 1) For amortizing products, this is based on the contractual repayments owed by the borrower over a 12 month or lifetime basis.
- 2) 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 an 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:

	Stage 1 12-month ECL \$	Stage 2 Lifetime ECL \$	Stage 3 Lifetime ECL \$	Total \$
Personal banking				
Loss allowance as at January 1, 2018	822	660	81	1,563
Transfers				
Transfer from Stage 1	369	(369)	-	-
Transfer from Stage 2	(8)	8	-	-
Transfer from Stage 3	-	(2)	2	-
Movements with P&L impact				
New financial assets originated	114	352	9	475
Changes in PDs/LGDs/EADs	(180)	130	4	(46)
Remeasurements	(365)	532	142	309
Financial assets derecognized during the period	(120)	(138)	(75)	(333)
Write-offs	-	-	(103)	(103)
Loss allowance as at December 31, 2018	632	1,173	60	1,865

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Business banking	Stage 1 12-month ECL \$	Stage 2 Lifetime ECL \$	Stage 3 Lifetime ECL \$	Total \$
Loss allowance as at January 1, 2018	1,080	1,604	560	3,244
Transfers				
Transfer from Stage 1	374	(374)	-	-
Transfer from Stage 2	(8)	8	-	-
Transfer from Stage 3	-	(142)	142	-
Movements with P&L impact				
New financial assets originated	235	336	271	842
Changes in PDs/LGDs/EADs	(97)	264	31	198
Remeasurements	(409)	222	256	69
Financial assets derecognized during the period	(88)	(679)	(551)	(1,318)
Write-offs	-	-	(66)	(66)
Loss allowance as at December 31, 2018	<u>1,087</u>	<u>1,239</u>	<u>643</u>	<u>2,969</u>

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, 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	0.55	53.00	100.00
Lines of credit	0.35	66.00	100.00
Business banking			
Mortgages	1.40	53.00	100.00
Loans	0.75	53.00	100.00
Lines of credit	0.75	66.00	100.00

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	Stage 1 12-month PD %	Stage 2 Lifetime PD %	Stage 3 Lifetime PD %
Personal banking – January 1, 2018			
Residential mortgages (insured and uninsured)	0.40	47.00	100.00
Equity lines of credit	0.20	56.00	100.00
Loans	0.70	47.00	100.00
Lines of credit	0.50	56.00	100.00
Business banking			
Mortgages	1.30	47.00	100.00
Loans	0.80	47.00	100.00
Lines of credit	0.80	56.00	100.00
	Stage 1 12-month LGD %	Stage 2 Lifetime LGD %	Stage 3 Lifetime LGD %
Personal banking – December 31, 2018			
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			
Mortgages	1.55	1.55	1.55
Loans	100.00	100.00	100.00
Lines of credit	100.00	100.00	100.00
	Stage 1 12-month LGD %	Stage 2 Lifetime LGD %	Stage 3 Lifetime LGD %
Personal banking – January 1, 2018			
Residential mortgages (insured)	0.73	0.73	0.73
Residential mortgages (uninsured)	0.60	0.60	0.60
Equity lines of credit	0.60	0.60	0.60
Loans	100.00	100.00	100.00
Lines of credit	100.00	100.00	100.00
Business banking			
Mortgages	1.23	1.23	1.23
Loans	100.00	100.00	100.00
Lines of credit	100.00	100.00	100.00

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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, 2018	January 1, 2018
	\$	\$
Personal banking – PD sensitivity		
Impact of: 1% increase	1,726	1,598
1% decrease	(1,726)	(1,598)
Business banking – PD sensitivity		
Impact of: 1% increase	1,374	1,323
1% decrease	(1,374)	(1,323)
Personal banking – LGD sensitivity		
Impact of: 1% increase	299	246
1% decrease	(299)	(246)
Business banking – LGD sensitivity		
Impact of: 1% increase	244	212
1% decrease	(244)	(212)

The sensitivity of a 1% increase or decrease to the PD assumptions for the total Personal banking portfolio is +/- \$1,726 (January 1, 2018 – \$1,598), with the highest sensitivity being in the personal line of credit segment of +/- \$1,320 (January 1, 2018 +/- \$1,227).

The sensitivity of a 1% increase or decrease to the PD assumptions for the total Business banking portfolio is +/- \$1,374 (January 1, 2018 +/- \$1,323), with the highest sensitivity being in the commercial line of credit segment of +/- \$840 (January 1, 2018 +/- \$835).

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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:

Groupings for collective measurement

- 1) The nature of the borrower
- 2) Collateral type
- 3) 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.

- iii) 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:

- 1) Mortgages over residential properties;
- 2) Charges over business assets such as premises, inventory and accounts receivable; and
- 3) 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.

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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.

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:

December 31, 2018	Gross exposure \$	Impairment allowance \$	Carrying amount \$
Credit impaired assets			
Personal banking loans measured at amortized cost	391	60	1,326
Business banking	5,918	643	6,033
Total credit-impaired assets	6,309	703	7,359
January 1, 2018	Gross exposure \$	Impairment allowance \$	Carrying amount \$
Credit impaired assets			
Personal banking loans measured at amortized cost	81	81	419
Business banking	1,665	560	2,139
Total credit-impaired assets	1,746	641	2,558

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	2018 Credit impaired (Gross carrying amount) \$	2017 Credit impaired (Gross carrying amount) \$
Lower than 50%	752	2,030
50 to 60%	770	-
61 to 70%	3,858	-
71 to 80%	946	-
81 to 90%	335	112
91 to 100%	-	159
Higher than 100%	-	-
Total	6,661	2,301

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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:

- 1) less than 90 days past due and there is no information that an impairment event has occurred; or
- 2) fully secured and collection efforts are reasonably expected to result in repayment.

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

	2018			2017	
	1-29 days	30-89 days	90 days and greater	Total	Total
	\$	\$	\$	\$	\$
Personal Banking					
Residential mortgages	11,363	1,868	-	13,231	14,087
Loans measured at amortized cost	134	200	-	334	157
Loans measured at fair value	4,709	2,444	-	7,153	7,772
Business Banking mortgages and loans	1,724	912	-	2,636	5,823
	17,930	5,424	-	23,354	27,839

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(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.

Credit risk exposure			2018	2017
	Outstanding \$	Undrawn commitments \$	Total exposure \$	Net \$
Cash and cash equivalents	48,156	-	48,156	7,630
Interest bearing deposits	386,159	-	386,159	402,830
Personal Banking				
Mortgages	1,991,751	47,929	2,039,680	1,908,001
Loans	113,755	1,283	115,038	162,224
Line of credit and overdraft	217,708	346,143	563,851	518,771
Business Banking				
Mortgages	800,019	78,752	878,771	773,108
Loans	25,478	1,605	27,083	25,982
Line of credit and overdraft	31,816	60,660	92,476	82,661
Accrued interest on loans	5,291	-	5,291	4,371
Derivative financial instruments	465	-	465	67
Investments	159,713	-	159,713	140,957
Accounts receivable	2,665	-	2,665	5,883
Income taxes receivable	535	-	535	579
Total exposure	3,783,511	536,372	4,319,883	4,033,064

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.

b) 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 expected income following the prepayment and does not result in a loss or reduction from interest accrued and earned prior to the date of prepayment.

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i) Crelogix

In contrast, due to the nature of the contractual arrangements of the Crelogix 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 6). Any such gain or loss is recorded through other income within the consolidated statement of income and comprehensive income (note 19).

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.

c) 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 \$289,887 (2017 – \$270,562).

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 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.

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 of Directors. 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.

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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 \$	Total \$
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
2017				
Deposits	2,175,683	728,780	-	2,904,463
Borrowings				
Money market loans	28,533	-	-	28,533
Subordinated debt	-	-	15,000	15,000
Secured borrowings	39,213	125,179	274,849	439,241
Derivative liabilities	5,027	-	-	5,027

d) 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 of Directors 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.

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

i) Interest rate risk

Interest rate risk is the risk that the future cash flows or value of the Credit Union's financial instruments will fluctuate due to changes in market interest rates. Interest rate risk arises when there is variability or a mismatch in the timing of maturing and repricing assets and liabilities.

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1) 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 26.

2) 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, 2018, the Credit Union estimates that an immediate and sustained 100 basis point increase in interest rates would decrease net interest income by \$1,608 (2017 – (\$677)) over the next 12 months while an immediate and sustained 100 basis point decrease in interest rates would increase net interest income by \$217 (2017 – (\$1,313)) 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.

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 variable rate category.

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

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								
Notional amount of derivatives		(45,557)	(477,701)	(823,393)	1,391,568	76,974	(121,891)	-
		-	(234,000)	44,000	190,000	-	-	-
Net mismatch		(45,557)	(711,701)	(779,393)	1,581,568	76,974	(121,891)	-

2017

	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	-	-	-	-	-	7,630	7,630
Interest bearing deposits	1.42	-	-	12,000	390,830	-	-	402,830
Derivative financial instruments	0.85	-	18	26	3	20	-	67
Loans	3.04	801,160	82,552	185,128	1,804,137	98,446	3,491	2,974,914
Investments	1.71	14,010	17,750	22,128	74,992	-	12,077	140,957
Other	-	-	-	-	-	-	22,564	22,564
		815,170	100,320	219,282	2,269,962	98,466	45,762	3,548,962
Liabilities and Members' Equity								
Borrowings	1.72	-	28,730	39,016	399,921	15,000	107	482,774
Deposits	1.30	920,128	268,945	967,726	728,780	-	18,884	2,904,463
Derivative financial instruments	0.09	-	-	5	5,022	-	-	5,027
Other	-	-	-	-	-	-	156,698	156,698
		920,128	297,675	1,006,747	1,133,723	15,000	175,689	3,548,962
Statement of financial position mismatch								
Notional amount of derivatives		(104,958)	(197,355)	(787,465)	1,136,239	83,466	(129,927)	-
		-	(199,000)	(15,000)	214,000	-	-	-
Net mismatch		(104,958)	(396,355)	(802,465)	1,350,239	83,466	(129,927)	-

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e) 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.

25 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 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, 2018 and December 31, 2017. 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.

The capital ratio as determined by FICOM'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:

	2018 \$	2017 \$
Equity shares	6,814	7,047
Retained earnings (non-consolidated)	142,967	140,186
Deferred income tax assets	(2,480)	(2,147)
50% of the Credit Union's proportion of retained earnings in CUDIC, Central 1 and Stabilization Central Credit Union as advised by FICOM	39,177	26,537
Subordinated debt	15,000	15,000
Deductions from capital	(689)	(1,125)
	<hr/> 200,789	<hr/> 185,498

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26 Derivative financial instruments and hedge accounting

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

	2018		2017	
	Notional amount \$	Fair value \$	Notional amount \$	Fair value \$
Equity options	277	11	505	56
Interest rate swaps	314,000	(3,324)	269,000	(5,016)
		<u>(3,313)</u>		<u>(4,960)</u>

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 in the 'Net' column the result if all set-off rights were exercised.

	Amounts not offset		Net
	Financial instruments \$	Cash collateral pledged received \$	\$
2018			
Derivative assets	454	-	454
Derivative liabilities	(3,778)	-	(3,778)
2017			
Derivative assets	11	-	11
Derivative liabilities	(5,027)	-	(5,027)

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.

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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, 2018, \$1,205 (net of tax of \$246) (2017 – (\$3,154) (net of tax of (\$612))) was the effective portion of changes in fair value for cash flow hedges in the year. This amount represents unrealized net losses on derivatives and is recorded in other comprehensive income. The ineffective portion transferred to the consolidated statement of income was \$66 (net of tax of \$14) (2017 – \$164 (net of tax of \$34)).

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. During the year ended December 31, 2018, \$248 (2017 – (\$1,852)) was recorded in net interest income as unrealized changes in fair value of these derivatives. In addition, net interest income includes \$194 (2017 – (\$762)) in realized net losses, of which \$nil (2017 – \$nil) was released from other comprehensive income.

- 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 \$617 as at December 31, 2018 (2017 – \$11). 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.

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

	Notional \$	Assets \$	Liabilities \$	Balance sheet line item(s)	Carrying amount	Changes in fair value used for calculating ineffectiveness \$
Cash flow hedges	270,000	465	3,778	Derivatives		3,201

The following table contains details of the hedged exposures covered by the Credit Union's hedging strategies:

	Carrying amount of hedged item		Accumulated amount of fair value adjustments on the hedged item		Balance sheet line item	Change in fair value of hedged item for ineffectiveness assessment \$	Cash flow hedge reserve	
	Assets \$	Liabilities \$	Assets \$	Liabilities \$			Continuing hedges \$	Discontinued hedges \$
Cash flow hedges	-	-	-	-	N/A	3,201	3,201	-

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:

	Gain (loss) recognized in OCT \$	Hedge ineffectiveness recognized in P&L \$	P&L line item that includes hedge ineffectiveness	Amounts reclassified from reserves to P&L as	
				Hedged item affected P&L \$	P&L line item that includes reclassified amount \$
Cash flow hedges	1,205	98	Interest income	113	Interest income

27 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.

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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.

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

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

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, 2017, \$2,668 (net of tax of (\$546)) was recognized in other comprehensive income (loss) for the year, as an unrealized change in fair value of AFS investments. During the year ended December 31, 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.

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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 carrying value.

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

	2018			2017		
	Carrying value \$	Fair value \$	Difference \$	Carrying value \$	Fair value \$	Difference \$
Financial assets						
Interest bearing deposits	386,159	378,639	(7,520)	402,830	394,133	(8,697)
Derivative financial instruments	465	465	-	67	67	-
Investments	159,713	159,017	(696)	140,957	140,358	(599)
Loans	3,180,984	3,122,812	(58,172)	2,972,348	2,960,319	(12,029)
Financial liabilities						
Borrowings	581,505	591,413	9,908	482,774	495,810	13,036
Deposits	3,060,878	3,063,503	2,625	2,904,863	2,897,003	(7,860)
Derivative financial instruments	3,778	3,778	-	5,027	5,027	-

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.

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	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
	2017		
	Level 1	Level 2	Level 3
	\$	\$	\$
Financial assets			
Interest bearing deposits	-	394,133	-
Derivative financial instruments	-	67	-
Investments	-	123,851	16,507
Loans	-	2,820,008	140,311
Financial liabilities			
Borrowings	-	(495,810)	-
Deposits	-	(2,897,003)	-
Derivative financial instruments	-	(5,027)	-
	-	(59,781)	156,818

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:

	2018	2017
	\$	\$
At January 1	156,818	13,170
Changes in loans measured at fair value (note 6)	(44,012)	140,311
Changes in Central 1 equity shares and other investments	1,310	3,337
At December 31	114,116	156,818

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28 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 (2017 – \$nil).

	2018 \$	2017 \$
i) Loans to related parties:		
Loans outstanding at January 1	4,931	5,769
Loans issued in the year	3,564	5,520
Loan repayments in the year	(4,134)	(6,358)
	<hr/>	<hr/>
Loans outstanding at December 31	4,361	4,931
	<hr/>	<hr/>
Interest income earned	129	153
	<hr/>	<hr/>
ii) Deposits from related parties:		
Balance on deposit at January 1	6,731	6,022
Deposits received in the year	16,214	18,825
Deposits repaid in the year	(18,928)	(18,116)
	<hr/>	<hr/>
Balance on deposit at December 31	4,017	6,731
	<hr/>	<hr/>
Interest expense on deposits	87	96
	<hr/>	<hr/>

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b) Key management compensation

	2018	2017
	\$	\$
Salary and other short-term employee benefits	3,306	3,269
Post-employment benefits	313	320
Other long-term benefits	6	-
Termination benefits	83	159
	<hr/>	<hr/>
	3,708	3,748
	<hr/>	<hr/>

29 Subsequent events

On February 28, 2019 the Board of Directors of Prospera Credit Union submitted an application to FICOM to request consent with respect to a proposed amalgamation of Prospera Credit Union and Westminster Savings Credit Union to form a new credit union. This Application is being submitted pursuant to Section 20 of the Credit Union Incorporation Act (British Columbia) and in accordance with guidelines provided for in FICOM Bulletin No. CU-18-001 (the “Bulletin”).