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Prospera Credit Union
MANAGEMENT'S DISCUSSION AND ANALYSIS
For the year ended December 31, 2014

INTRODUCTION

Prospera Credit Union (Prospera) is a BC-based credit union serving members from the Okanagan to Vancouver. As a full service financial institution, Prospera offers a wide range of products and services including Personal Banking, Business Banking and Wealth Management and serves members through a network of 16 branches, online and mobile banking, The Exchange ATM network and a locally based Contact Centre.

2014 HIGHLIGHTS

It was a solid year for Prospera Credit Union in terms of portfolio growth in all of our lines of business, which include: Personal Banking, Business Banking and Wealth Management. We grew our retained earnings with strong net income in the year despite a challenging economic environment and a competitive landscape in our primary markets.

As forecast, interest rates remained low throughout 2014 due to poor global market conditions and competitors within the financial sector, both large and small, jockeyed for position. For Prospera, this resulted in greater than expected top-line growth but lower levels of profitability on the bottom line. Given that we have been operating in a similar environment for a number of years, our objective throughout 2014 was to stay on course, focusing on our service and advice strategy and keeping costs under control while still investing in those areas that are needed to grow the business and achieve our strategic objectives.

For the first time in five years, Prospera experienced net membership growth with our total membership at year end exceeding 62,800. This is a very positive indication that our focus on building meaningful relationships with our members is paying off.

Building on our reputation as a grassroots financial organization, Humanomics™ was a new brand that we introduced this year in collaboration with a number of credit unions from across the country. The impetus of Humanomics is to make economics about people and look for opportunities to help members save money and do better financially. Our first two Humanomics offerings (one in the spring and one in the fall) featured a savings account for youth and a financial education booklet that families can use to teach their kids about earning, saving and managing money. In its first year, Humanomics brought close to 200 new members to Prospera.

Another significant development in 2014 was the exploration of a merger with Westminster Savings Credit Union, which was announced in September. Due diligence work began shortly thereafter and following several months of information gathering and weighing the benefits and costs, both Westminster Savings and Prospera agreed that it was not the right time to move forward with a merger.

OVERVIEW OF 2014 OPERATING RESULTS

For Prospera, 2014 was a successful year with solid performance and moderate growth. Assets Under Administration surpassed $3.3 billion, increasing 8% (or $265 million) in the year as a result of growth in both the balance sheet and Wealth Management portfolio. Deposits and loans each grew by 5%, providing the Credit Union with solid growth on our balance sheet amidst intense competitive pressures in all lines of business. The Wealth Management portfolio performed well due to asset growth and market appreciation as equity markets in both Canada and the US reached all-time highs. The Credit Union further enhanced its overall liquidity position to 11.2%, up from 10.3% in 2013, which is well above the 8% minimum required.

At $8.7 million, Net Income from Operations (or Income before dividends on member deposit shares) decreased slightly in 2014 (8%). Top line (or Net Interest Income and other income) growth of $2.7m was absorbed through expenditures mainly due to increased operating and regulatory costs. These earnings contributed to Members' Equity, which grew $4.4 million, representing an increase of 4% over 2013. Growth in Retained Earnings provides support for Prospera's capital base. Our Capital Adequacy Ratio, inclusive of system capital, was 12.6% at year end, down from 13.1% in 2013, which easily exceeds both regulatory and internal policy requirements. The regulatory requirement is a minimum of 8%.

BALANCE SHEET

Assets

Total assets grew 7% (or $169 million) to $2.6 billion. This increase was driven by strong lending with support from historically low interest rates. Total loans to members increased by 5% (or $116 million) to $2.3 billion during the year. Personal Banking loans grew $100 million, increasing the portfolio to $1.7 billion. Growth was relatively consistent across all regions with little impact from various regulatory changes related to home mortgage insurance through CMHC. Prospera used a variety of channels to originate mortgages, which all demonstrated robust activity. Business Banking loan growth contributed another $14 million to end the year at $612 million. Assets were further supported by growth in Prospera's deposits with other financial institutions, which also grew by $41 million. This growth in deposits strengthens our overall liquidity position and provides management with flexibility to fund loans.

Liabilities
Total liabilities grew by 7% (or $165 million), which includes member deposit growth of 5% (or $108 million) to $2.3 billion in the year. Two initiatives related to deposits in recent years have gained traction. Deposit Anywhere™ continues to see growth as an increasing number of members use the service to deposit cheques using a mobile device. Likewise, our business account bundles are popular with business members for providing convenience, while encouraging the use of our full suite of products. Borrowings for the year grew $54 million, to a total of $227 million, with the most significant growth in the area of secured borrowings, which increased by $55 million to $183 million. Secured borrowings provide a long term and stable form of funding, something that is more difficult to achieve through member deposits (primarily due to low interest rates).

Members’ Equity
Members’ Equity grew by 4% (or $4 million) and includes Retained Earnings growth and changes in Other Reserves. Retained Earnings grew by $7 million in 2014, which was a strong result given market conditions. Retained Earnings reflect the equity that is derived from the accumulation of Prospera’s earnings before Other Comprehensive Income (OCI). The intent of OCI is to capture and identify unrealised market gains and losses which flow through to Other Reserves within Members’ Equity. From year to year this category can swing from positive to negative as valuation changes relating to derivatives and pension obligations are taken into account. During the year Prospera recorded an unrealized loss of $2.7 million in OCI related to our future pension obligations which is a further reflection of the reduced rate environment.

INCOME STATEMENT
Net Interest Income
The interest income earned on mortgages rose year over year by $1.2 million aided by increased lending of $116 million, despite an overall reduction in portfolio yield as mortgages renew at lower rates. On the other hand, deposit costs remained flat while the portfolio grew $108 million. Deposit cost changes are slower to respond than loans in a declining rate environment as early renewals are less favourable. In addition, we earned revenue from our liquidity management activities combining for an overall improvement to Net Interest Income of $2.4 million to $54.1 million.

Other income
Total Other Income increased by $380 thousand to $12.6 million. This includes revenues from Wealth Management, transactional services and foreign exchange. A highlight in 2014 was our Wealth Management revenue, which increased by $1 million and exceeded $5 million. This is reflective of the strong portfolio increase which includes both market value appreciation and new investments. Revenue in other areas remained stable over the year.

Operating Expenses
Total Non-Interest Expenses for the year increased by $3.4 million to $56.2 million. The increase reflects investments into various areas of the business. Employee costs account for $2.2 million in increases, and this investment allows Prospera to maintain our current programs while attracting the right talent. Occupancy increased in line with maintaining and updating our existing branch infrastructure. As part of our property management activities, Prospera took the opportunity to repurchase the Chilliwack Branch location in the fall. This purchase allows us to fix our property costs and strengthens our investment in the area. On the information technology side, we developed a Unique Member Identification system that improves our service delivery to members. We also invested in a number of new programs, including Humanomics (as mentioned above), which is in collaboration with various credit unions across Canada.

2015 OUTLOOK

We caution readers on the use of this forward looking information. Our performance is subject to change due to economic conditions, changes in interest rates or legislation governing credit unions in British Columbia.

The environment that we do business in has changed significantly over the years, not only in terms of rates but also the behaviour of consumers, regulators and central banks that drive the economy. The most recent actions of the Bank of Canada tell us that we should expect more of the same throughout 2015 which is that rates will remain low, margins will continue to be under pressure and the market will continue to be competitive.

Our plan for 2015 is to achieve a similar level of growth to the current year which was accomplished through hard work and strong risk management strategies. Board and management review our strategic plan annually to ensure we are on track and employ the right resources to drive Prospera forward. Many opportunities exist to collaborate within the credit union system or to partner with suppliers and we are an active participant in these efforts.

RISK MANAGEMENT FRAMEWORK

As a financial institution, Prospera is subject to a variety of risks that are inherent to the business. Effective risk management is fundamental to our success. The primary goals of risk management are to ensure that the outcomes of risk-taking activities are consistent with our strategies and risk appetite (as outlined by the Board) and that there is an appropriate balance between risk and reward in order to maximize member benefit. The principal risks are focused on the areas of credit, liquidity and changing interest rates. Prospera has developed an enterprise-wide risk management framework that helps us understand and mitigate these and all other identified risks through continued monitoring and analysis. Prospera also works with an Internal Capital Adequacy Assessment Process (ICAAP) model to help ensure that our capital levels are sufficient to cover ongoing operations and all material risks as they are understood by management.

Prospera's risk management policies are designed to identify and analyze risks, to set appropriate risk limits and controls, and to monitor the risks and adherence to limits by means of reliable and up-to-date information systems. Prospera's approach involves identifying particular events or circumstances relevant to its objectives, assessing them in terms of probability and magnitude, determining a response strategy and monitoring progress. We regularly review our risk management policies and systems to take into account changes in markets and products as well as best practices.

Risk management is carried out by a number of delegated committees reporting to the Board. The Board provides written principles for risk tolerance and overall risk management and management reports to the Board on compliance with Prospera's risk management policies. In addition, Prospera maintains an internal audit function, which is responsible for the independent review of risk management and our control environment.

Principal Risks

CREDIT RISK – Credit risk is primarily related to the risk of financial loss due to the inability to fully collect on amounts due to Prospera. This includes loans to members and other counterparties that we engage with. Prospera has a comprehensive set of controls around prudent lending practices and these practices are reviewed regularly to ensure that they are adhered to and appropriate given the risks that exist. Prospera maintains an allowance for credit losses on the balance sheet and continuously monitors the required level of this allowance through a comprehensive model that outlines the potential risks within our portfolio.

LIQUIDITY RISK – Liquidity risk is the risk that Prospera will encounter difficulty in raising funds to meet its obligations to members and other liabilities. To mitigate this risk, Prospera continuously monitors current and upcoming liquidity levels to ensure that we are able to meet funding and operational requirements and maintain a minimum threshold.

INTEREST RATE RISK – Interest rate risk is the risk of loss that results from changing interest rates. This impacts many areas of operational earnings including interest on loans, deposits and other investments.

OTHER – Other risks identified and considered in our risk management framework include the risk of loss related to areas such as operational, regulatory compliance, strategic and reputational.