Management Discussion and Analysis

Above: Nicole Kwasnicki and Shannon Lucas, employees and members, Assiniboia
Management Discussion and Analysis

This Management Discussion and Analysis (MD&A) enables readers to assess material changes in the financial condition and operating results of Conexus Credit Union (Conexus) for the year ending on December 31, 2013 compared with the prior year, planned results, and future strategies. This MD&A is prepared in conjunction with the Consolidated Financial Statements and related Notes for the year ending December 31, 2013, and should be read together with those documents. This MD&A includes information up to February 7, 2014. Unless otherwise indicated, all amounts are expressed in Canadian dollars. Amounts for 2010, 2011, 2012, and 2013 have been primarily derived from Conexus’ annual consolidated financial statements, prepared in accordance with International Financial Reporting Standards (IFRS).

The following items provide an overview of topics discussed throughout the MD&A:

Economic Conditions
- 2013 economic and financial services conditions
- Economic and financial outlook for 2014

Financial Performance to Plan
- Financial management

Financial Position Review
- Overview
- Credit quality
- Liquidity management
- Capital management

Financial Performance Review
- Profitability
- Efficiency
- Patronage allocations

Enterprise Risk Management
- Overview of significant risks

Caution Regarding Forward-looking Statements

This MD&A might contain forward-looking statements concerning future strategies of Conexus. These statements involve uncertainties in relation to prevailing economic, legislative, and regulatory conditions at the time of writing. Therefore, actual results may differ from the forward-looking statements contained in this discussion.

Factors That May Affect Future Results

Although Conexus is focused in Saskatchewan, the economic and business conditions in Canada and abroad can affect the trading areas of Conexus and its financial position. Global economic conditions can influence Canada and local economies, affecting businesses, consumer prices, and personal incomes. The prevailing conditions nationally can have an effect on financial markets and the Bank of Canada's monetary policy, causing changes in interest rates and the value of the Canadian dollar. Fluctuations in the capital markets and the extent of local competition can impact on the market share and price of Conexus’ products and services. All these factors affect the environmental conditions in which Conexus operates and, accordingly, Conexus’ performance.

Economic Conditions

2013 Economic and Financial Services Conditions

In 2013, the global economy continued to see positive growth, although at a slightly slower pace than in 2012. The global economy grew 3.0% in 2013, edging down from the 3.1% growth in 2012. Growth has undoubtedly been uneven with emerging and developing economies growing at 4.7% during the year, while advanced economies struggled along with 1.3% growth. Although the eurozone was still reeling from the effects of the sovereign debt crisis, conditions appear to be improving as the struggling economic area exited its longest-ever recession in the second quarter of 2013. At the same time, the world’s largest economy, the United States (U.S.), continued to persevere through its fiscal troubles.

Economic growth in the U.S., Canada’s largest trade partner, fell from 2.8% in 2012 to 1.9% in 2013. The deceleration in growth primarily reflected a reduction in non-residential fixed investment, federal government spending, personal consumption, and exports. Despite slower economic growth in 2013, other economic indicators suggest that the U.S. is heading in a positive direction. The unemployment rate steadily declined throughout 2013 and came in at 6.7% in December, well below the 10.0% recessionary peak in October 2009. Increased numbers of jobs, along with rising stock and housing prices, helped push household net worth in the third quarter of 2013 to a record level. Against a generally positive economic backdrop, the U.S. Federal Reserve decided to push ahead with its plan to taper its bond-buying program. The plan instilled confidence in the markets, and yields on government bonds drifted higher in both the U.S. and Canada during the second half of 2013.
Canada’s economic growth remained flat at 1.7% from 2012 to 2013. The heavily resource-based economy suffered from softer commodity prices, which have affected investment in the resource sector. Headline inflation averaged a mere 0.9% throughout 2013, and the Bank of Canada’s core measure was 1.2%. Both measures fall at the low end of the Bank’s 1.0-3.0% target range. The export sector has still not recovered to its pre-recession level of activity, but an improving U.S. economy and depreciating Canadian dollar, which fell about 6.5% in 2013, should help boost Canadian exports in the upcoming year.

It is estimated that Saskatchewan’s economy grew by 3.2% in 2013, ranking second among Canadian provinces in terms of economic growth. A bumper crop helped the province achieve record crop production levels at 38.4 million tonnes. Although agricultural commodity prices were significantly lower due to excess supply, Saskatchewan’s real GDP was boosted due to higher sale volumes and exports. A continuing uncertain market for potash with a lower price environment, however, affected potash production. Lower-than-expected potash royalties prompted a narrowing of the surplus in the Saskatchewan government’s second quarter update; nevertheless, the government’s fiscal position remained one of the strongest in Canada. The province’s labour market led the country as job creation rose to 3.4% in 2013, up from 2.1% in 2012. Furthermore, the unemployment rate in the province fell from 4.7% in 2012 to 3.9% in 2013, well below the national rate of 7.2%. The strong labour market drove population growth, helping the province claim second place in population growth after Alberta. On the retail sales front, growth is expected to have softened from last year’s figures, though they remain among the top three in Canada. While housing starts in 2012 were robust at 9,968, they fell to 8,290 in 2013.

Yields on government bonds in both the U.S. and Canada drifted higher in the second half of 2013 after the U.S. Federal Reserve noted that the U.S. economy was healthy enough for it to start to consider tapering its bond-buying program. Shorter-term interest rates have remained low as the Bank of Canada held the overnight rate at 1.0% throughout 2013, where it has remained since September 2010. It is widely expected that the Bank will not raise the overnight rate until 2015. That being said, the Canadian financial system and its institutions have been regarded as the “world’s strongest,” and this has resulted in Canadian businesses and consumers experiencing unhindered access to borrowings at relatively low interest throughout 2013. Savers, however, had to contend with low investment rates in the deposit market.

Economic and Financial Outlook for 2014

The outlook for the overall global economy is expected to improve in 2014. Global economic growth is projected at 3.7% in 2014, an increase over the projected growth of 3.0% in 2013. Growth in emerging-market economies is projected to reach 5.1% in 2014, increasing 0.6% over 2013. The eurozone is finally expected to post positive economic growth of 1.0% following years of negative growth. Economists expect, however, that the recovery will be uneven. High debt will reduce domestic demand, but exports should help with growth. The U.S. economy is also expected to pick up, with 2014 GDP forecasts at 2.8%, up from 1.9% in 2013. The U.S. Federal Reserve will likely continue reducing monthly asset purchases throughout the year, conditional on the strength and progress of the U.S. economy.

The Bank of Canada expects the Canadian economy to accelerate in 2014 and 2015, with economic growth at 2.5% for both years, implying that the economy will gradually return to capacity over the following two years (January 2014 Monetary Policy Report). With the recent decline in the Canadian dollar and a recovering U.S. economy, exports should improve, leading to stronger business confidence and investment in Canada. The Bank’s outlook for inflation is now even lower than previously anticipated due to significant excess supply in the economy and heightened competition in the retail sector. With the view that inflation will take two years to reach its 2.0% target, the pressure to raise the target for the overnight rate remains low. Given the inflation forecast, it is widely expected that short-term interest rates will remain flat throughout 2014.

Over the next year, Saskatchewan’s economic growth is expected to exceed the national average and remain among the fastest-growing provinces in the country. That being said, growth is expected to slow modestly in 2014. Though the province experienced record year-over-year growth in overall agricultural output in 2013, its agricultural production will likely decrease to more normal levels in 2014. Consequently, real GDP growth is expected to decelerate from the 2013 rate. The job market in the province remains a bright spot, as the province will continue to enjoy the lowest unemployment rate in Canada, projected at 4.2%, and the second-strongest employment growth after Alberta. Although forecasters expect Saskatchewan’s housing starts to slow moderately in 2014, they anticipate that retail sales will accelerate beyond their 2013 pace. Overall, a strong Saskatchewan economy and low interest rates are expected to support both business and consumer credit growth in 2014. Deposits held by businesses should moderate as funds are invested into operations and expansions, and personal deposits are expected to grow at a similar rate to 2013.
Financial Performance to Plan

Each year, Conexus develops a corporate plan through a comprehensive budget and planning process. The following table provides an overview of key financial measures compared to targets for 2013. Actual results for 2012, 2011, and 2010 have also been included for comparison:

Financial Management

<table>
<thead>
<tr>
<th>(In thousands of CDN $)</th>
<th>2013 Actual</th>
<th>2013 Plan</th>
<th>2012 Actual</th>
<th>2011 Actual</th>
<th>2010 Actual</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Growth</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Assets</td>
<td>4,697,919</td>
<td>4,544,981</td>
<td>4,202,015</td>
<td>3,816,910</td>
<td>3,566,805</td>
</tr>
<tr>
<td>Asset growth</td>
<td>11.80%</td>
<td>8.16%</td>
<td>10.09%</td>
<td>7.01%</td>
<td>6.65%</td>
</tr>
<tr>
<td>Deposits</td>
<td>3,847,137</td>
<td>3,829,933</td>
<td>3,531,661</td>
<td>3,227,745</td>
<td>3,011,327</td>
</tr>
<tr>
<td>Deposit growth</td>
<td>8.93%</td>
<td>8.45%</td>
<td>9.42%</td>
<td>7.19%</td>
<td>5.56%</td>
</tr>
<tr>
<td>Loans and advances</td>
<td>3,961,710</td>
<td>3,704,605</td>
<td>3,464,830</td>
<td>3,159,491</td>
<td>2,981,887</td>
</tr>
<tr>
<td>Loans and advances growth</td>
<td>14.34%</td>
<td>6.92%</td>
<td>9.66%</td>
<td>5.96%</td>
<td>9.12%</td>
</tr>
<tr>
<td><strong>Credit quality</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Delinquency greater than 90 days</td>
<td>0.45%</td>
<td>0.47%</td>
<td>0.63%</td>
<td>0.67%</td>
<td>1.79%</td>
</tr>
<tr>
<td>Net impaired loans and advances</td>
<td>2,260</td>
<td>3,478</td>
<td>4,082</td>
<td>7,005</td>
<td>22,005</td>
</tr>
<tr>
<td>Allowance for credit losses</td>
<td>11,425</td>
<td>8,089</td>
<td>9,075</td>
<td>6,143</td>
<td>18,553</td>
</tr>
<tr>
<td>Loan impairment charges</td>
<td>4,419</td>
<td>2,320</td>
<td>4,878</td>
<td>7,106</td>
<td>7,508</td>
</tr>
<tr>
<td><strong>Liquidity management</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Liquid assets *</td>
<td>598,264</td>
<td>674,333</td>
<td>606,973</td>
<td>534,648</td>
<td>440,066</td>
</tr>
<tr>
<td>Loan to asset ratio</td>
<td>84.32%</td>
<td>81.51%</td>
<td>82.48%</td>
<td>82.78%</td>
<td>83.60%</td>
</tr>
<tr>
<td>Investment securities</td>
<td>548,911</td>
<td>699,307</td>
<td>510,961</td>
<td>479,482</td>
<td>396,634</td>
</tr>
<tr>
<td>Operating liquidity ratio</td>
<td>223%</td>
<td>150%</td>
<td>250%</td>
<td>239%</td>
<td>217%</td>
</tr>
<tr>
<td><strong>Capital management</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Risk-weighted capital **</td>
<td>11.88%</td>
<td>12.29%</td>
<td>11.70%</td>
<td>11.14%</td>
<td>10.82%</td>
</tr>
<tr>
<td>Common equity tier 1 capital to risk-weighted assets ***</td>
<td>10.91%</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Minimum leverage ratio ***</td>
<td>7.10%</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Total capital ****</td>
<td>358,038</td>
<td>358,109</td>
<td>321,967</td>
<td>286,987</td>
<td>262,331</td>
</tr>
<tr>
<td><strong>Profitability and member return</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total comprehensive income for the year</td>
<td>29,178</td>
<td>31,485</td>
<td>32,930</td>
<td>21,049</td>
<td>23,852</td>
</tr>
<tr>
<td>Return on assets (ROA) before member equity accounts and tax allocations</td>
<td>0.90%</td>
<td>0.94%</td>
<td>1.05%</td>
<td>0.62%</td>
<td>0.93%</td>
</tr>
<tr>
<td>Efficiency ratio</td>
<td>74.17%</td>
<td>72.65%</td>
<td>72.26%</td>
<td>81.38%</td>
<td>74.31%</td>
</tr>
<tr>
<td>Patronage allocations</td>
<td>5,914</td>
<td>5,797</td>
<td>5,566</td>
<td>2,735</td>
<td>5,450</td>
</tr>
</tbody>
</table>

* Liquid assets include cash and cash equivalents, marketable investment securities, liquid investment securities held with Concentra, and statutory liquidity investment securities at SaskCentral.

** New calculation method under Basel III capital standards framework for 2013. 2012 and prior years are based on Basel II capital standards framework.

*** New ratios under Basel III capital standards framework which became effective in 2013 therefore prior years numbers are not available.

**** Total capital of Conexus consists of amounts held in membership shares and member equity accounts ($27.99 million in 2013); accumulated other comprehensive income ($0.34 million in 2013); and retained earnings ($329.71 million in 2013). This differs from the definition of total capital used by the Credit Union Deposit Guarantee Corporation, which amounts to $351,515 (2012 – $321,489).
Financial Position Review

The financial position review provides an analysis of our major balance sheet categories and a review of our deposits, loans and advances, liquidity, and capital positions. The review is based on the consolidated financial statements and credit-union-only results, where appropriate. Consolidated financial statements include the operational results of the credit union as well as the following subsidiaries: insurance, mortgage brokerage, and holding companies.

Overview

Total funds under management ended 2013 at $6.04 billion, up from $5.28 billion in 2012 and achieving total growth of 14.39%. Other funds under management, or “off-balance sheet” assets under administration, include: $747.98 million in wealth management, up from $626.04 million in 2012 or an increase of 19.48%; and $590.88 million in syndicated loans and advances, an increase of 30.78% over 2012 levels of $451.80 million.

Assets

“On-balance sheet” assets ended 2013 at $4.70 billion, compared to $4.20 billion in 2012, which represented growth of 11.80%.

The following illustrates the Credit Union’s growth in “on-balance sheet” assets over the past five years.

Assets

*Amounts have been restated to reflect IFRS transition adjustments
The following illustrates Conexus’ deposit and loans and advances growth over the last five years.

**Deposits**

Deposits ended 2013 at $3.85 billion compared to $3.53 billion in 2012, representing growth of 8.93%. Conexus’ deposits consist of deposits from both consumer and commercial members.

### Deposits

- **Deposits ended 2013 at $3.85 billion compared to $3.53 billion in 2012, representing growth of 8.93%.**
- **Consumer deposits accounted for 62.04% of total deposits in 2013 (2012 – 64.14%), and commercial deposits accounted for 34.12% of total deposits (2012 – 32.40%).**
- **Conexus’ deposits are 100% guaranteed by the regulator of credit unions in Saskatchewan, the Credit Union Deposit Guarantee Corporation (CUDGC).**

### Loans and Advances (loans)

Loans accounted for 84.32% of total assets, and amounted to $3.96 billion as of December 31, 2013, representing an increase of 14.34% over the previous year’s balance of $3.46 billion.

### Loans

- **A significant portion of Conexus’ loan portfolio continues to consist of stable, low-risk consumer mortgages. Loan allocation to the consumer sector increased from 37.49% in the previous year to end 2013 at 39.82%. Loan allocation to the commercial sector declined slightly from the previous year, being 35.31% in 2013 compared to 36.24% in 2012. The agriculture sector increased slightly compared to the previous year, ending 2013 at 9.05%.**
Credit Quality

Credit quality metrics (loan delinquency and net impaired loans as a percentage of total loans) have again improved significantly in the year, and remain at five-year bests. The sound credit quality has been supported by a strong provincial economy and the communities in which Conexus operates.

Past due loans and advances
Loans and advances are considered past due when a counterparty is contractually in arrears but where payment in full is expected. Delinquency greater than 90 days was 0.45% for 2013, an improvement from 0.63% in 2012.

Loan Delinquency Greater Than 90 Days

*Amounts have not been restated to IFRS and are presented in accordance with Canadian GAAP*
Net Impaired Loans and Advances

Net impaired loans are loans and advances considered by management to be uncollectible and are net of individual and collective loan allowances. It is the amount expected to be realized on the sale of any security on the uncollectible loans and advances. In 2013, net impaired loans and advances showed a decrease from the previous year of $1.8 million to end the year at $2.3 million (2012 - $4.1 million). As a percentage of total loans and advances, net impaired loans and advances decreased from 0.12% in 2012 to end 2013 at 0.06%.

Net Impaired Loans

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Net Impaired Loans

<table>
<thead>
<tr>
<th>Year</th>
<th>Net Impaired Loans (NIL)</th>
<th>NIL as % of Total Loans</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009*</td>
<td>16,316</td>
<td>0.00%</td>
</tr>
<tr>
<td>2010</td>
<td>22,005</td>
<td>0.00%</td>
</tr>
<tr>
<td>2011</td>
<td>7,005</td>
<td>0.50%</td>
</tr>
<tr>
<td>2012</td>
<td>4,082</td>
<td>1.00%</td>
</tr>
<tr>
<td>2013</td>
<td>2,260</td>
<td>1.50%</td>
</tr>
</tbody>
</table>

*Amounts have not been restated to IFRS and are presented in accordance with Canadian GAAP

Allowance for Credit Losses

Conexus monitors its exposure to potential credit losses and maintains both individual and collective loan allowances accordingly.

Individual allowances are based on management’s estimate of the net realizable value (NRV) of impaired loans and advances. The NRV includes any estimated future cash flows from loan payments as well as proceeds from the sale of any security. Total individual allowances increased from $7.94 million in 2012 to $10.64 million at the end of 2013.

Collective allowances provide for probable loan portfolio losses that have not been specifically identified as impaired. Collective allowances are assessed on six portfolio groups. Each group behaves similarly with respect to collectability, loss trigger events, and credit risk factors. These groups include: commercial mortgage and non-mortgage, consumer mortgage and non-mortgage, and agricultural mortgage and non-mortgage. Total collective allowances decreased from $1.14 million in 2012 to $0.79 million in 2013.

Allowance for Credit Losses

<table>
<thead>
<tr>
<th>Year</th>
<th>Individual Allowance</th>
<th>Collective Allowance</th>
<th>Allowance as % of Loans</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009*</td>
<td>20,463</td>
<td>18,553</td>
<td>0.00%</td>
</tr>
<tr>
<td>2010</td>
<td>18,553</td>
<td>6,143</td>
<td>0.20%</td>
</tr>
<tr>
<td>2011</td>
<td>6,143</td>
<td>9,075</td>
<td>0.40%</td>
</tr>
<tr>
<td>2012</td>
<td>9,075</td>
<td>11,425</td>
<td>0.60%</td>
</tr>
<tr>
<td>2013</td>
<td>11,425</td>
<td>14,000</td>
<td>1.00%</td>
</tr>
</tbody>
</table>

*Amounts have not been restated to IFRS and are presented in accordance with Canadian GAAP
Loan Impairment Charges
Once allowances for credit losses and write-offs have been assessed, a loan impairment charge is expensed on the Consolidated Statement of Comprehensive Income. Loan impairment charges (individual and collective) were $4.42 million in 2013. The loan impairment charges as a percentage of total loans and advances decreased from 0.14% in 2012 to 0.11% in 2013.

Liquidity Management
Managing liquidity is essential to maintaining the safety and soundness of the Credit Union, depositor confidence, and stability in earnings. It is Conexus’ policy to ensure that sufficient liquid assets and funding capacities are available to meet commitments as they become due, even under stressed conditions. Conexus defines and manages its liquidity management framework within established corporate policies and regulatory standards.

The principles of Conexus’ liquidity management framework are: maintaining a strategy and policies for managing liquidity risk; maintaining a stock of liquid assets; measuring and monitoring funding requirements; managing market access to funding sources; contingency planning; and ensuring internal controls over liquidity risk management processes.

Conexus has an established liquidity policy, along with a number of processes and practices governing the management of funding requirements. Specifically, Conexus measures and monitors its available liquidity and performs monthly stress scenario modeling to identify sources of potential liquidity strain. Conexus has built and maintains access to numerous funding sources. The organization’s primary source of funds is consumer deposits in the amount of $2.42 billion in 2013 (2012 – $2.29 billion), which represents 62.04% of total deposits in 2013 (2012 – 64.14%). This is followed by commercial deposits in the amount of $1.33 billion in 2013 (2012 – $1.16 billion) at 34.12% (2012 – 32.40%).

In addition to core deposits, Conexus maintains external borrowing facilities from various sources. Conexus has an authorized line of credit with Credit Union Central of Saskatchewan (SaskCentral) in the amount of $75 million in Canadian funds, as well as authorized lines of credit with Concentra Financial Services Association (Concentra) in the amount of $7 million in U.S. funds and $25 million in Canadian funds. In 2013, Conexus entered into a credit agreement with Caisse Centrale Desjardins, with a maximum available credit limit of $50 million. During the year, Conexus rarely used external borrowing facilities and held no outstanding balance at the end of the year (2012 – $nil). SaskCentral is a wholesale financial services co-operative that provides trade association and liquidity management services to its member owners – the Saskatchewan credit unions. Concentra is owned by SaskCentral, other provincial centrals, and credit union partners; it provides wholesale banking services and consulting support to Canadian credit unions.

The next source of liquidity for Conexus is the securitization of assets for the purpose of generating funds on the capital markets. Conexus’ securitization activities include participation in the Canada Mortgage Bond (CMB) program, the sale of mortgage-backed securities (MBS), and a revolving dealer finance loan pool. Loans and advances are also syndicated with numerous credit unions for liquidity purposes. In 2013, Conexus securitized an additional $195.71 million in loans and advances (2012 – $80.29 million) and syndicated an additional $159.28 million in loans and advances (2012 – $216.22 million) as part of its ongoing funding strategies.

Using these various funding sources achieves liquidity diversification.

Liquid Assets
Conexus also maintains a cushion of high-quality liquid assets that it can draw upon to meet unforeseen funding requirements.

Liquid assets include cash and cash equivalents, marketable investment securities, liquid investment securities held with Concentra, and statutory liquidity investment securities at SaskCentral. The value of liquid assets decreased from $606.97 million (14.44% of assets) in 2012 to $598.26 million (12.73% of assets) as of December 31, 2013.
Saskatchewan credit unions are required by the provincial regulator, CUDGC, to maintain 10% of their liabilities on deposit with SaskCentral, manager of the Provincial Liquidity Program. Throughout 2013, Conexus held the required amount of investment securities with SaskCentral for the purpose of maintaining its obligation to the Provincial Liquidity Program. In addition to the statutory liquidity investment securities on deposit with SaskCentral, Conexus maintains a high-quality, liquid pool of investment securities to satisfy payment obligations and protect against unforeseen liquidity events. The majority of Conexus’ marketable investment securities are held with Concentra, Canadian (Schedule 1) Chartered Banks, and provincial governments.

### Liquid Assets

<table>
<thead>
<tr>
<th>Year</th>
<th>Liquid Assets</th>
<th>Liquid Assets as a % of Total Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009*</td>
<td>443,832</td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td>440,066</td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td>534,648</td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td>606,973</td>
<td></td>
</tr>
<tr>
<td>2013</td>
<td>598,264</td>
<td></td>
</tr>
</tbody>
</table>

*Amounts have not been restated to IFRS and are presented in accordance with Canadian GAAP

### Operating Liquidity

Conexus’ liquidity is measured by the operating liquidity ratio. This ratio is calculated as available liquidity and cash inflows divided by cash outflows. Available liquidity is defined as investment securities which are immediately available as cash, investment securities marketable in an active secondary market, redeemable investment securities held with Concentra, and committed credit facilities. In 2012, the ratio was 250.00%, and in 2013 it was 223.00%, which are both well above management’s internal target of 150.00%.

### Capital Management

Total capital as a percentage of risk-weighted assets is one of our primary measures of financial strength. Conexus’ capital management framework is designed to maintain an optimal level of capital. Accordingly, capital policies are designed to ensure that Conexus: meets its regulatory capital requirements; meets its internal assessment of required capital; and builds long-term membership value. Conexus retains a portion of its annual earnings in order to meet these capital objectives. Once these capital objectives are met, additional earnings are allocated to members through Conexus’ Member Equity Program. The Member Equity Program allocates earnings to members’ equity accounts (in the form of membership shares) based on usage of services. Member equity accounts are included in the determination of capital adequacy for internal and regulatory purposes.

The provincial credit union regulator (CUDGC) prescribes capital adequacy measures and minimum capital requirements. The capital adequacy rules issued by CUDGC are based on the Basel III capital standards framework established by the Bank for International Settlements and adopted by financial institutions around the globe, including Canadian banks. Revised capital adequacy standards issued by CUDGC, based upon the Basel III capital standards framework, came into effect on July 1, 2013. Conexus monitors changes in regulatory standards and guidelines and adjusts its capital plan and targets accordingly.

CUDGC currently prescribes four standardized tests to assess the capital adequacy of credit unions: risk-weighted capital ratio (total eligible capital to risk-weighted assets); common equity tier 1 capital to risk-weighted assets; total tier 1 capital to risk-weighted assets; and a minimum leverage ratio (eligible capital to total leveraged assets). The risk-weighted capital ratio is calculated as total eligible capital divided by risk-weighted assets. Regulatory standards require credit unions to maintain a minimum risk-weighted capital ratio of 8%, a minimum common equity tier 1 capital to risk-weighted assets of 4.5%, total tier 1 capital to risk-weighted assets of 6.0%, and a minimum leverage ratio of 5.0%.

CUDGC also prescribes an internal capital adequacy assessment process (ICAAP). ICAAP is an integrated process that evaluates capital adequacy. It is used to establish capital targets that take into consideration the strategic direction (business plan) and risk appetite of the credit union. ICAAP seeks to identify the material risks requiring capital and quantify the amount of capital that should be held in relation to those risks. Enterprise-wide stress testing and scenario analysis are also used to assess the impact of various stress conditions on Conexus’ risk profile and capital requirements.

Achieving minimum regulatory capital levels are of paramount importance to Conexus. Minimum board-level standards are set well in excess of regulatory minimums. Board policy requires the credit union to maintain a minimum risk-weighted capital ratio of 11.0%, a minimum common equity tier 1 capital to risk-weighted assets of 7%, a minimum total tier 1 equity to risk-weighted assets of 8.5%, and a minimum leverage ratio of 5.75%. This standard-setting is the first line of defense to ensure capital levels exceed regulatory
minimums even in times of significant loss or unplanned growth. In addition to board-level minimums for capital adequacy, internal capital targets are set and reviewed annually through the Credit Union’s ICAAP. ICAAP targets and the underlying risk assessment process is approved annually by the Audit and Risk Committee of the board. Conexus manages capital to these operating objectives. Balance sheet operating strategies are designed to ensure these capital levels are achieved in addition to other strategies, such as growth and profitability targets.

Capital planning is integrated with Conexus’ business planning. Conexus’ capital plan must demonstrate its ability to meet both board-level capital standards and those established through ICAAP.

Conexus experienced capital growth in 2013, adding to its sound financial position. In 2013, the total capital of Conexus increased by $36.07 million, from $321.97 million in 2012 to $358.04 million. Total capital of Conexus consists of: amounts held in membership shares and member equity accounts ($27.99 million in 2013); accumulated other comprehensive income (AOCI) ($0.30 million in 2013); and retained earnings ($329.71 million in 2013). The following chart illustrates the capital composition of Conexus, showing that retained earnings remain the key sources of capital for Conexus.

**Regulatory Capital**

For the year ending 2013, Conexus’ total capital as a percentage of risk-weighted assets was 11.88% (2012 – 11.70%). The calculation of this ratio changed slightly in 2013 under the new Basel III capital standards framework adopted by CUDGC. Previous years were not restated.

Basel III introduced two new capital measures in 2013. The first is the common equity tier 1 capital to risk-weighted assets, which was 10.91% in 2013, well above the minimum regulatory standard of 4.5%. The second is the minimum leverage ratio, which was 7.10% for Conexus in 2013, also well above the minimum regulatory standard of 5%. The previous year’s numbers are not available for these ratios. Both ratios were above internal policy minimums established by Conexus.
Financial Performance Review

The financial performance review provides an analysis of our consolidated financial performance and member return. The results below are drawn from continuing operations unless otherwise specified.

Profitability

Total comprehensive income for the year was $29.18 million, a decrease from $32.93 million in the previous year. For 2013, our total annualized return on assets (ROA) before patronage and income tax was 0.90%, compared to 1.05% in 2012.

Total Comprehensive Income and ROA

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Comprehensive Income</th>
<th>ROA Before Patronage and Income Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009*</td>
<td>14,815 (in 000's)</td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td>23,852 (in 000's)</td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td>21,049 (in 000's)</td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td>32,930 (in 000's)</td>
<td>2.50%</td>
</tr>
<tr>
<td>2013</td>
<td>29,178 (in 000's)</td>
<td>2.00%</td>
</tr>
</tbody>
</table>

*Amounts have not been restated to IFRS and are presented in accordance with Canadian GAAP

Total comprehensive income comprises the following items:

- Net interest income after impairment charges: consists of total interest income less total interest expenses and patronage allocation while factoring in any loans and advances and investment security impairment charges. Net interest income increased $3.48 million between December 31, 2012 and 2013. Expressed as a percentage of total assets, net interest income was 2.34% for 2013 compared to 2.53% in 2012.
- Other income: includes account service fees, loan fees, loan insurance fees, ABM fees, insurance commission income, dividend income, and wealth management income. Consolidated other income decreased to $43.95 million in 2013 from $45.63 million in 2012.
- Operating expenses: includes various operating costs such as general business, occupancy, organizational, personnel, and member security. Consolidated operating expense from continuing operations increased in dollar value but decreased as a percentage of assets, from 2.70% of assets or $113.27 million in 2012 to 2.49% of assets or $117.26 million in 2013.
Efficiency

The efficiency ratio measures the percentage of income from continuing operations earned that is spent on the operation of the business. A low-efficiency ratio indicates efficient use of resources. The ratio is calculated as operating expenses from continuing operations divided by the sum of the following: net interest income plus other income from continuing operations and loan impairment charges.

The efficiency ratio was 74.17% as compared to 72.26% in 2012, an unfavourable increase of 1.91%. This increase is primarily caused by a decline in Conexus’ interest margin due to a continued low interest rate environment and competition.

![Efficiency Ratio Graph]

*Amounts have not been restated to IFRS and are presented in accordance with Canadian GAAP

Patronage Allocations

The board of directors of Conexus declared that a patronage allocation equal to 4.00% of personal members’ qualifying interest earned and interest paid in 2013 (2012 – 4.00%) would be credited to members’ equity and deposit accounts. The board of directors of Conexus also declared that a patronage allocation equal to 2.00% of non-personal members’ qualifying interest earned and interest paid in 2013 (2012 – 2.00%) would be credited to members’ equity or deposit accounts. Based on 2013 results, Conexus will return $5.91 million of earnings to members through the Member Equity Program (2012 – $5.57 million). Members, in accordance with the terms of the Member Equity Program, received $2.28 million in the form of cash distributions, and $3.63 million in the form of membership shares (held in their equity accounts).

![Patronage Allocations Graph]

*Amounts have not been restated to IFRS and are presented in accordance with Canadian GAAP

In addition to patronage allocations, Conexus contributes a significant amount to Saskatchewan communities each year. In 2013, $2.02 million (2012 – $1.87 million) was returned to communities around the province in the form of contributions to various community projects. This amount is included in operating expenses under the general business category.
Enterprise Risk Management

Overview

As a financial institution, Conexus is exposed to a variety of risks. To actively manage its risks, Conexus has implemented an enterprise-wide risk management (ERM) approach, which identifies, measures, and monitors risks.

Risk Governance

Risk governance includes setting the risk appetite and policy, determining an appropriate organizational structure, and clearly defining authority and responsibility for risk decisions. The following groups and committees have the authority and responsibility to make risk decisions within Conexus.

Board of Directors

- Set strategy and high-level objectives
- Approve risk policies and set risk appetite
- Know the extent to which effective ERM has been established within the organization
- Be aware of significant risks and whether management has appropriately responded
- Review and assess the impact of business strategies, opportunities, and initiatives on overall risk position

Audit and Risk Committee

- Monitor major risks and recommend acceptable risk levels to the board
- Review the appropriateness and effectiveness of risk management and compliance practices
- Provide oversight of external and internal audit functions

Executive Management

- Ensure, through the chief executive officer, that all ERM components are in place
- Set objectives, establish organizational structure, and develop the risk culture
- Ensure that a supportive learning environment exists

Management Risk Committee

- Oversee the ERM function
- Ensure compliance with the risk appetite
- Review status of significant risk areas and key risks
- Review and recommend changes to board policy
- Review operating policy changes
- Review and recommend risk appetite statement to the board

Chief Risk Officer

- Lead the ERM function
- Ensure risk is considered in strategic direction-setting
- Support and demonstrate the importance of ERM
- Maintain and develop the risk governance framework

ERM Department

- Act as a centralized co-ordinator to facilitate ERM
- Establish ERM policies, define roles and responsibilities, and set goals for implementation
- Promote ERM competence
- Examine and evaluate the effectiveness of the ERM framework, tracking progress and reporting on best practices
- Oversee the insurance risk management program
- Oversee the business continuity plan

Senior Management

- Manage risk related to unit objectives
- Assume responsibility and accountability
- Integrate risk management into department strategy and management practices
- Identify events, assess risks, and respond accordingly
**Internal Audit, Compliance and ERM Departments**

- Oversee enterprise-wide management of compliance throughout the organization
- Provide independent and objective assurance of control and soundness of operations to management and the Audit and Risk Committee of the board
- Monitor compliance with policy and procedure, and the adequacy of controls

**Credit Management Department**

- Establish credit policies and oversee credit risk management
- Monitor credit risk profile and risk exposures
- Monitor compliance with credit risk policies
- Approve high-risk individual credit applications

**Asset Liability Committee**

- Establish market and liquidity risk policies and oversee related programs and practices
- Monitor overall market and liquidity risk profile, key and emerging risk exposures, and risk management activities
- Monitor compliance with market and liquidity risk policies
- Establish balance sheet operational strategies with a focus on achieving financial targets, managing market and liquidity risk, and optimizing the use of capital

**Pricing Committee**

- Establish pricing policies and tools
- Ensure that policies facilitate appropriate return given the level of risk in individual accounts
- Monitor pricing decisions to ensure compliance to policy

**Functional Advisors/Supervisors**

- Provide support in shaping effective ERM components
- Ensure policy-related advice and guidance is in line with corporate ERM and strategic objectives
- Identify and assess risk and the effectiveness of existing risk management practices
- Help design and implement tools for more effective risk management

**All Employees**

- Be aware of risk management issues
- Practice risk smart behaviour
- Consider limitations and understand the risks they can and cannot take
- Execute day-to-day activities in accordance with established directives and protocols

**Risk Identification, Measurement and Assessment**

The ERM framework sets out how risk management is designed and will function at Conexus. Risks will be identified and assessed, and mitigation plans will be documented, through the use of a risk register. Risks are evaluated and prioritized on the potential impact that they could have and the likelihood that they might occur.

Risks considered to be at a tolerable risk level are managed through normal operating policy and procedures. Risks carrying a slightly higher risk level receive ongoing monitoring. Risks carrying high risk levels are escalated to the management risk committee for monitoring, and they are reported to the board. If any risk is assessed as intolerable, a timely and appropriate response is required.

**Risk Monitoring and Reporting**

ERM reporting requirements are specified in board policy. Reports are submitted quarterly to the Audit and Risk Committee, providing updates on significant risk categories, key business risks, and the progress of ERM program implementation. In addition, the full board of directors receives an annual ERM report. This report includes risk details such as a listing of key risks, a risk map, and an evaluation of the ERM program implementation. Internal audit, and occasionally the Credit Union Deposit Guarantee Corporation, also completes an independent evaluation.

A dedicated executive-level risk committee, the Management Risk Committee, meets at least quarterly to review significant risk categories, and to discuss changes to the risk environment, risk impacts on strategic objectives, and emerging risks.

**Risk Control and Mitigation**

Management implements policies and procedures to carry out risk mitigation and treatment actions. The Conexus ERM framework establishes that risk owners are generally responsible for controls. The ERM department reports on the adequacy of controls, and the internal audit department tests controls and reports on whether they are functioning as intended.

The executive team takes risks into consideration when creating the corporate plan and balanced scorecard. Key initiatives have been put in place to manage risk priorities.
Significant Risk Areas

In addition to tracking individual key risks, analysis is done on the following six categories of risk that are significant to Conexus: strategic, market, liquidity, credit, legal and regulatory, and operational. Within each of these categories are various individual risks, and Conexus recognizes that any combination of the above-noted risks can affect the organization's reputational risk.

For each risk area, Conexus conducts an assessment to measure the inherent risks in that area and the effectiveness of risk management controls. Inherent risk is the “raw” risk of the category if controls were not in place. It can be rated as low, moderate, above average, or high. The effectiveness of risk management controls can be rated as satisfactory, needs improvement, or inadequate.

A. Strategic Risk

Strategic risk encompasses the possibility that business decisions or plans could be flawed, and thus impact our ability to meet objectives. This risk can take the form of adverse business decisions, or ineffective or inappropriate business plans. It could also be a failure to respond to changes in the competitive environment, member preferences, or product obsolescence. Products and services must be competitive and profitable, and resources must be used appropriately in order for Conexus to be successful.

Key Strategic Risks
The following are key strategic risks that have been identified at Conexus:

- Aging membership – The membership demographic shows that the majority of our members are in the 45+ age groups.
- Competition – Increased pressure from within the financial services industry and renewed interest in the Saskatchewan market will continue to test our ability to maintain member satisfaction.

Strategic Risk Management
Conexus has an ongoing strategic planning cycle, which includes planning sessions for the board and executive management. Strategic and operational planning is organized and led by the governance and strategy department. Strategic objectives, performance measures, and key initiatives are identified and form part of the balanced scorecard, which is communicated to all staff and used to measure organizational performance. Risk identification is part of Conexus' operational planning process, ensuring that strategic risk identification is incorporated at all levels within the organization.

The inherent risk level of strategic risk is rated as above average, the same as it was in 2012. Risk management practices are rated as needs improvement.

B. Market Risk

Market risk is the exposure to potential loss from changes in market prices or rates. Losses can occur when values of assets and liabilities, or changes in revenues or expenses, are adversely affected by changes in market conditions, such as interest rate or foreign exchange movements. At Conexus, market risk primarily arises from movements in interest rates and is caused specifically from timing differences in the re-pricing of assets and liabilities, both on and off the balance sheet.

Key Market Risks
The following key risks have been identified in this category:

- Access to capital – To maintain strength and stability, Conexus is required to grow or access capital to achieve capital adequacy targets in an environment of increased balance sheet growth, innovation investment, economic uncertainty, and regulatory expectations.

Market Risk Management
Effective management of market risk includes documented board and operating policies which address roles and responsibilities, delegation of authority and limits, risk measurement and reporting, valuation and back testing, hedging policies, and exception management. Some elements of market risk management have been discussed in other parts of this report. Market risk exposure limits have been set in Conexus policy, and methods of scenario and stress testing are carried out to determine if the limits are exceeded. The corporate finance department is responsible for reporting on and monitoring market risk, with oversight by the Asset Liability Committee and reporting provided quarterly to the board of directors. Interest rate risk management includes the use of derivatives to exchange floating rate and fixed rate cash flows.

The inherent risk level of market risk at Conexus is moderate, an improvement over the 2012 level. Risk management practices are rated as satisfactory.

C. Liquidity Risk

Liquidity risk is the potential inability to meet obligations, such as liability maturities, deposit withdrawals, or funding loans, without incurring unacceptable losses. Liquidity risk includes the inability to manage unplanned decreases or changes in funding sources.
Key Liquidity Risks
The following key risks have been identified in this category:

- Liquidity risk – There is potential for Conexus to be unable to secure sufficient deposits and other diversified liquidity structures at a reasonable price to match the loan demand of a growing Saskatchewan economy. The credit union national liquidity structure comprises provincial credit union centrals. Each provincial credit union central maintains its own standards for liquid asset characteristics and volumes.

Liquidity Risk Management
Liquidity risk management includes board and operating policies which address roles and responsibilities, delegation of authority and limits, risk measurements, stress testing, and reporting. Operational management of liquidity risk includes daily, monthly, and annual liquidity management processes and planning. Liquidity planning takes into account the Conexus strategic plan, diversity of on- and off-balance sheet funding sources, and diversity and liquidity of assets. Some elements of liquidity risk management have been discussed in other parts of this report. The corporate finance department is responsible for reporting on and monitoring liquidity risk, with oversight by the Asset Liability Committee and reporting provided quarterly to the board of directors.

The inherent risk level of liquidity risk is high, an increase over 2012 levels. Risk management practices are rated as needs improvement.

D. Credit Risk

Credit risk is the loss of principal resulting from a borrower’s failure to repay a contractual credit obligation. Credit losses occur when the borrower fails to make contractual payments and the realizable value of security is less than the outstanding principal of the credit.

At Conexus, credit risk comes primarily from our direct lending activities and, to a lesser extent, our holdings of investment securities.

Key Credit Risks
The following key risk has been identified in this category:

- Credit risk – The geographic limitations within which Conexus operates create a credit portfolio with increased geographic and industry concentrations resulting in higher levels of exposure to localized economic and natural events. The ongoing prosperity of the Saskatchewan economy, coupled with an extended period of low interest rates, has created an environment where an increase in interest rates could materially impact member debt service ratios.

Credit Risk Management
Credit granting is controlled by board-approved policies and detailed loan policy manuals. Credit approvals require escalation based on operational lending policy, which is reviewed on a scheduled basis. Quarterly credit management reports provide loan portfolio details on loans by industry type, internal risk weighting where available, and property type for mortgages. Credit portfolio management entails using a variety of strategies to achieve a target loan portfolio. The credit management centre is responsible for the creation of appropriate operating policy and the overall management of credit risk. The Asset Liability Committee sets operating targets for loan growth and portfolio mix, and recommends strategies to achieve those targets. A variety of appropriate strategies, ranging from special pricing on specific loans to syndication or securitization, are used.

The inherent risk level of credit risk is above average, the same as levels in 2012. Risk management practices are rated as needs improvement.

E. Legal & Regulatory Risk

Legal and regulatory risk is the risk arising from potential violations of or nonconformance with laws, rules, regulations, prescribed practices, or ethical standards.

Key Legal and Regulatory Risks
None of the risks identified in this category have been assessed as key risks.

Legal and Regulatory Risk Management
As a financial institution, Conexus operates in a heavily regulated environment. As a business operating within Saskatchewan, we are also subject to all provincial and federal legislation applicable to our operations, such as labour and anti-money-laundering laws. Board policy, operating policy, operating procedure, and a corporate code of conduct raise awareness and accountability in complying with laws and regulations.

A corporate compliance department that maintains risk oversight and co-ordinates quarterly reporting to the board is in place at Conexus. Operational compliance employees ensure compliance in key regulatory areas. All specialized departments (wealth management, credit, finance, and retail) are knowledgeable in the specific regulations applicable to their areas, and where required, third-party expertise is consulted to ensure sound decision-making. Employees are responsible for compliance within their scope of responsibilities. Mandatory annual training and reviews are required for specific regulatory requirements and key human resource operating policies and guidelines.
Expected legislative changes being monitored include the following: Privacy Act Amendments, Anti-Spam Fighting Internet and Wireless Spam Act (FISA), Foreign Account Tax Compliance Act (FATCA), Proceeds of Crime (Money Laundering), and Terrorist Financing Regulations Amendments. Some of these legislative changes are expected in the first half of 2014.

The inherent risk level of legal and regulatory risk is moderate, an improvement over 2012 levels. Risk management practices are considered satisfactory.

F. Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people, and systems, or external events. Exposures to this risk arise from deficiencies in internal controls, technology failures, human error, employee integrity, or natural disasters.

Key Operational Risks

The key risks identified in this category are:

- **Human resource risk** – An aging workforce, a shortage of skilled labour, and increased difficulty retaining employees, due to Saskatchewan’s economic prosperity, has the propensity to either create a deficit of employees or to create a workforce that lacks the leadership and change management experience needed to achieve corporate strategies. The pace of change associated with the initiation of a new culture, programs, systems, and processes creates employee capacity concerns and increased employee stress levels.

- **Technological innovation** – Due to rapid change in technology and member preference, Conexus could fail to leverage or make the investment into advancements in technology needed to deliver the systems, data, and member and employee experience required to advance the 2017 Vision and maintain data integrity.

- **Operational process risk** – There are numerous operating processes that are regionally inconsistent as a result of past merger activity. Continued use of outdated or inconsistent processes could lead to potential losses and will lead to inconsistent member delivery compared to brand promise, goals of the sales and service strategy, and goals of consistent and efficient operations.

- **Ability to recover from a disruptive event** – There is a high reliance on technology and continuity of service for member satisfaction. Business continuity management practices must align to service delivery objectives, data security objectives, and stakeholder expectations throughout disruptive events of varying degrees of severity.

- **Supply chain risk** – Conexus relies on numerous non-diversified partners, service providers, trade associations, and external relationships to deliver service to our members and enable strategy advancement. This reliance creates the potential for strategic misalignment, inappropriate services, and, with trade associations, inequitable funding of irrelevant structures or services.

Operational Risk Management

At Conexus, operational risk exists in all products and services, as well as in the way we deliver them, such as how we support back office processes and systems. We categorize our operating risk into three main areas: people, systems, and processes. The people category includes our human resources and covers risks such as our ability to attract and retain appropriate talent. The systems category addresses technology and our reliance on it, encompassing such risks as a security breach or failure of a critical system for an extended period. The processes category includes the way we do things and includes risks such as inaccurate policies or procedures.

Operational risk is managed through the use of preventative measures including policies and procedures, controls, and monitoring. Control and monitoring involves segregation of duties, employee training, performance management, and a structured internal audit program. Other mitigation includes business continuity planning, appropriate insurance coverage, and secure technology solutions.

Conexus’ people risk is controlled through board and operating policy, and it is specifically managed by the Conexus human resources department. Individual departments and managers are accountable to ensure appropriate hiring, training, and development of staff, as well as ongoing employee engagement and retention with the assistance of the human resource department.

System risk management is jointly controlled through a dedicated information technology department, which is responsible for ongoing system security and functionality, and individual departments, which are responsible to ensure the appropriateness of systems and data used at Conexus.

Process risk is managed through multiple channels. Board policy is reviewed and recommended by an executive-level committee for board approval. Operating policy and procedure, which is centrally available to all staff, is controlled through key departments with the required subject matter expertise, and it is also reviewed by an executive-level committee. The internal audit department conducts ongoing assessments of process compliance and reports the findings directly to the Audit and Risk Committee of the board.

The inherent risk for operational risk is assessed according to the three main operational risk categories, and 2013 levels are as follows: people risk is above average, systems risk is above average, and process risk is high. These risk levels represent an improvement over 2012 levels. Risk management practices are rated as needs improvement.