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2019 Management's Discussion & Analysis

Management’s Discussion & Analysis

This Management Discussion & Analysis (“MD&A”) is provided to assist Members with interpreting DUCA’s results of operations and financial condition for the fiscal year ended December 31, 2019, as compared to December 31, 2018. The MD&A should be read in conjunction with the audited financial statements, which have been prepared in accordance with International Financial Reporting Standards (“IFRS”). Effective January 1, 2019, DUCA adopted a new standard, IFRS 16: Leases (“IFRS 16”). Comparative periods have not been restated. The reclassifications and the adjustments arising from the new leasing rules are therefore recognized in the opening balance sheet on January 1, 2019. Accordingly, certain prior year figures may not be comparable. All amounts in the MD&A are expressed in Canadian dollars.

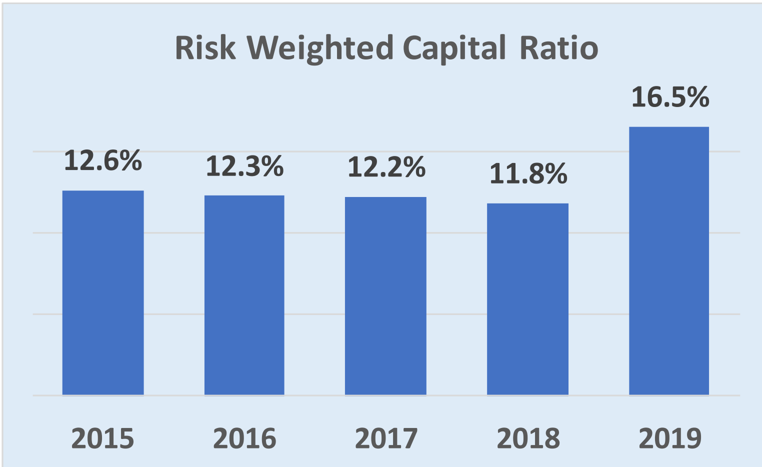
Caution Regarding Forward-Looking Statements

This MD&A may include forward-looking statements which by their very nature require management to make assumptions and involve inherent risks and uncertainties. Forward-looking statements are typically identified by the words “believe”, “expect”, “anticipate”, “intend”, “estimate”, “may increase”, “may impact”, and other similar expressions, or future or conditional verbs such as “will”, “should”, “would” and “could”. Several important factors, many of which are beyond management’s control, could cause actual future results, conditions, actions or events to differ materially from the targets, projections, expectations, estimates or intentions expressed in forward-looking statements. These factors include, but are not limited to, changes in general economic conditions in Canada, particularly those in Ontario; legislative or regulatory developments; changes in accounting standards or policies; and DUCA’s success in anticipating and managing the risks inherent in these factors. Readers are cautioned that the foregoing list is not exhaustive. Undue reliance should not be placed on forward-looking statements as actual results may differ materially from expectations. DUCA does not undertake to update any forward-looking statements contained in this annual report.

DUCA uses several financial measures to assess its performance. Some of these measures are not calculated in accordance with IFRS, are not defined by IFRS and do not have standardized meanings that would ensure consistency and comparability between companies using these measures. They are therefore unlikely to be comparable to similar measures presented by other credit unions and financial institutions and should not be viewed in isolation from or as a substitute for IFRS results.

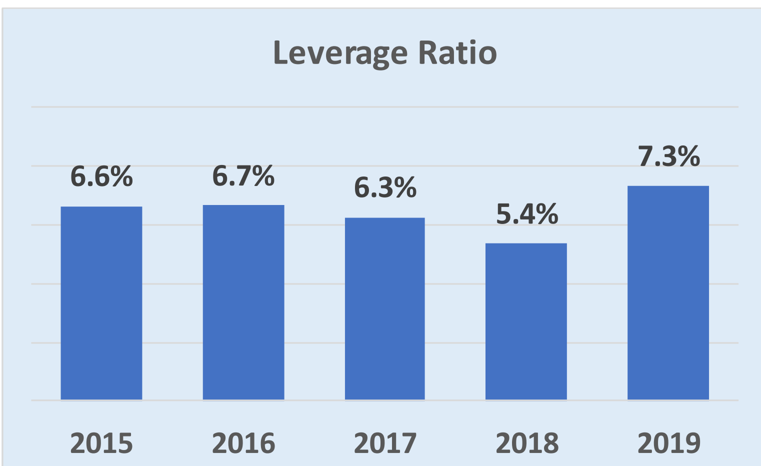
Financial Results Highlights

- Comprehensive income for the year ended December 31, 2019 was $12.0 million compared to $11.0 million for the year ended December 31, 2018.
- Income before patronage, tax and other comprehensive income for the year ended December 31, 2019 was $11.9 million compared to $16.1 million for the year ended December 31, 2018.
- Interest and investment revenue of $138.1 million for the year ended December 31, 2019 was up by $26.3 million or 23.5% year-over-year. Interest expense of $89.1 million for the year ended December 31, 2019 was up by $27.0 million or 43.4% year-over-year. Net interest income of $49.0 million was flat compared to the prior year.
- The recovery of credit losses of $(0.5) million was essentially flat year-over-year.
- Non-interest expense of $54.9 million was $14.0 million or 34.1% higher than the prior year.
- During 2019, DUCA recorded a tax refund totaling $2.7 million relating to certain tax rate adjustments from prior years.
- Return on average equity ("ROE") was 5.8% for the year ended December 31, 2019 compared with 7.2% for 2018.
- Total assets were $4.056 billion at December 31, 2019 compared with $3.374 billion at the end of 2018 and up 20.2% year-over-year.
- Assets under administration, which include off-balance sheet wealth management assets, were $4.373 billion compared with $3.597 billion in 2018, up 21.6% year-over-year.
- Member loans increased to $3.496 billion, up 16.6% from $2.998 billion at the end of 2018.
- Member deposits increased to $2.980 billion, up 17.4% from to $2.539 billion at the end of 2018.
- Securitization balances decreased to $583.2 million down 7.9% from $633.4 million at the end of 2018.
- DUCA returned $1.4 million to its Members in the form of a patronage return in 2019. Cumulatively, since 1998, DUCA has returned over $75.6 million to its Members in Class A dividends and patronage returns.
- DUCA has paid $3.9 million in dividends to holders of Class B Series 1 investment shares, cumulatively since 2017.
- The Leverage ratio was 7.3% at December 31, 2019 compared with 5.4% at the end of 2018. The regulatory minimum requirement is 4.0%.
- The Risk-Weighted capital ratio was 16.5% at December 31, 2019 compared with 11.8% at December 31, 2018. The regulatory minimum requirement is 8.0%.



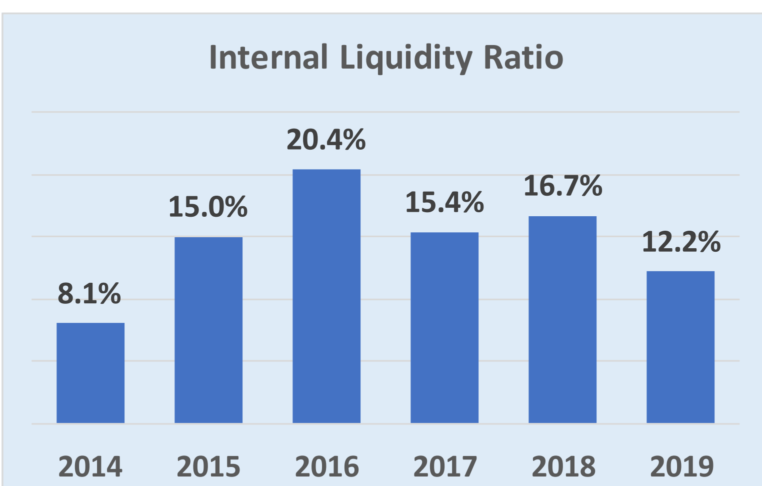
The **Risk Weighted Capital Ratio** is the ratio of regulatory capital divided by risk weighted assets, expressed as a percent. Risk weighted assets is the sum of the absolute value of assets in specified categories multiplied by a corresponding percent, varying between 0% and 100% depending on the risk attributed to each category.

The Financial Services Regulatory Authority of Ontario ("FSRA") requires a minimum risk weighted capital ratio of 8.0%. DUCA's Board of Directors has established a minimum ratio of 10.5% (2018 - 10.5%). This was 16.5% in 2019 compared with 11.8% in the prior year. The increase from 2018 is a result of $109.1 million Class B Series 4 shares raised by the Credit Union in 2019.



The **Leverage Ratio** is the ratio of regulatory capital divided by total assets.

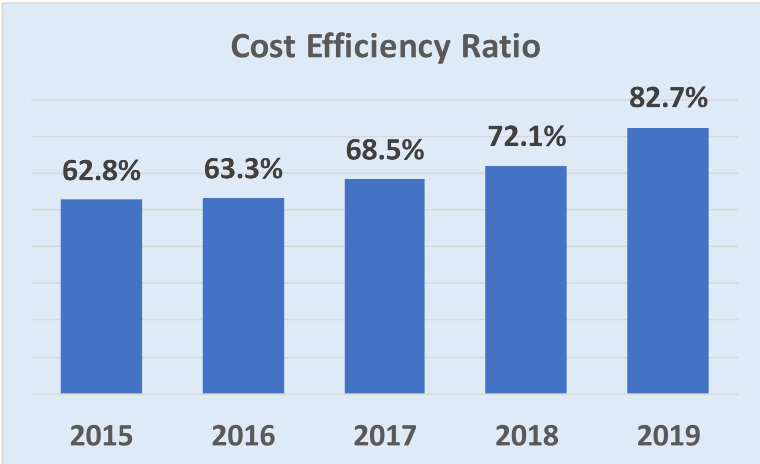
FSRA requires a minimum capital ratio of 4.0%. DUCA's Board of Directors has established a minimum Leverage ratio of 5.0% for 2019 (2018: 4.75%). The leverage ratio was 7.3% at December 31, 2019 compared with 5.4% in 2018. The increase from 2018 is a result of $109.1 million Class B Series 4 shares raised by the Credit Union in 2019 combined with an increase in retained earnings.



The **Internal Liquidity Ratio ("ILR")** is the ratio of total unencumbered liquid assets divided by total deposits and borrowings.

In 2019, DUCA's policy required the liquidity ratio to be a minimum of 10.0% (2018 - range of 10.0% - 20.0%). In 2019, ILR was 12.2% (2018 - 16.7%)

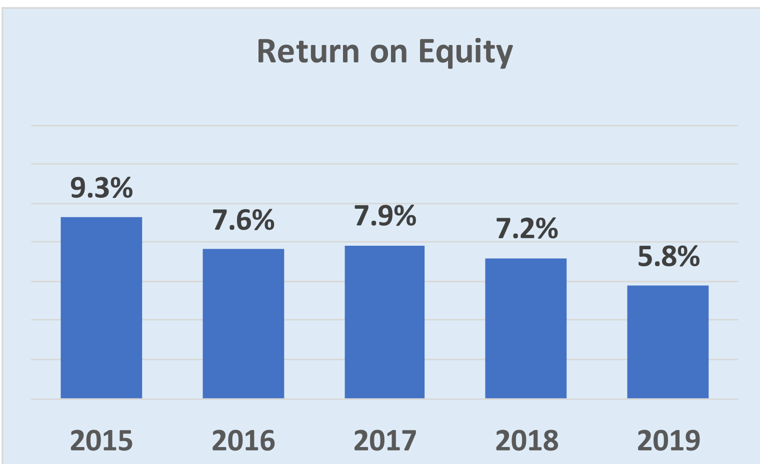
FSRA requires the Credit Union to comply with additional liquidity metrics which are discussed on pages 18 - 19.



The **Cost Efficiency Ratio ("CER")** (or **Expense-to-Revenue Ratio**) is a measure of operational efficiency. It is calculated as non-interest expense divided by total revenue, expressed as a percentage.

DUCA's CER was 82.7% for the year ended December 31, 2019, up from 72.1% in the prior year.

Net interest income and non-interest income increased by $9.6 million to $66.4 million and operating expenses increased by $14.0 million to $54.9 million. The increase in non-interest expense was focused on investment to support planned growth and development of the Credit Union.



The **Return on Equity** (ROE) is calculated as net income as a percentage of average Members' equity.

DUCA's ROE was 5.8% during 2019 compared to 7.2% in 2018 primarily due to higher level of capital as a result of the Class B Series 4 shares issued in 2019.

2019 Financial Performance Review

Net Interest Income

Net interest income is comprised of earnings on assets, such as loans and securities less interest expense paid on liabilities, such as deposits and securitizations. Net interest margin is the ratio of net interest income to average earning assets, expressed as a percentage or in basis points.

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

($ millions)	2019				2018			
	Average Balance	Interest	Mix	Rate	Average Balance	Interest	Mix	Rate
Cash Equivalents and Investments	430.9	14.1	11.6%	2.0%	342.7	7.2	11.1%	1.8%
Personal Loans/LOCs	16.2	0.8	0.4%	4.9%	13.2	0.6	0.4%	5.0%
Residential Mortgages	2,369.6	75.0	63.8%	3.2%	1,821.4	52.5	59.2%	2.8%
Commercial Loans/Mortgages	871.2	48.2	23.4%	5.5%	880.6	51.5	28.6%	5.8%
Other	27.3	-	0.7%		16.9	-	0.5%	
Total assets	3,715.2	138.1	100.0%	3.6%	3,074.8	111.8	100.0%	3.5%
Deposits	2,781.9	73.8	74.9%	2.5%	2,293.0	49.7	74.6%	2.1%
Borrowings & Securitization	683.8	15.3	18.4%	2.3%	600.0	12.4	19.5%	2.0%
Other	15.6	-	0.4%		11.0	-	0.4%	
Total liabilities	3,481.3	89.1	93.7%	2.4%	2,904.0	62.1	94.4%	2.1%
Members' equity	233.8	-	6.3%		171.0	-	5.6%	
Total liabilities and Members' equity	3,715.1	89.1	100.0%	2.3%	3,075.0	62.1	100.0%	2.0%
Net Interest Income		49.0		1.3%		49.7		1.5%

Interest and investment income were $138.1 million for the year ended December 31, 2019 compared with $111.8 million for the year ended December 31, 2018. The increase of $26.3 million or 23.5% was primarily a result of higher average interest earning assets, partially offset by overall lower average asset yields. Average yields on loans and investments were 3.6% for the year ended December 31, 2019 compared with 3.5% for the prior year. Lower commercial loan balances resulting from continued management efforts to manage down certain large commercial credit exposures contributed to the overall lower yields compared to the prior year.

Interest expense on deposits was $73.8 million for the year ended December 31, 2019 compared with $49.7 million for the prior year. The interest expense average rate on deposits was 2.5% compared with 2.1% for the prior year. The increase of 40 basis points was largely a result of a competitive deposit market and a rising interest rate environment and DUCA's high interest Earn More Savings promotional campaigns during the year.

Securitization and borrowing costs were $15.3 million, up $2.9 million or 23.4% due to higher levels of securitization balances and borrowings during 2019 and higher funding costs.

The overall average funding cost rate increased from 2.0% to 2.3% year-over-year, as a result of the aforementioned items.

The overall net interest margin was 1.3% for the year ended December 31, 2019 compared to 1.5% for the year ended December 31, 2018.

Non-Interest Income

($ millions)	2019			2018		
	Income	Mix	% of average assets	Income	Mix	% of average assets
Gain of sale of head office building	6.9	39.7%	0.2%	0.0	0.0%	0.0%
Mortgage and loan fees	3.0	17.4%	0.1%	2.4	34.6%	0.1%
Wealth management	2.0	11.3%	0.1%	1.6	22.8%	0.1%
Securitization income	1.7	9.8%	0.0%	0.0	0.0%	0.0%
Service charges	1.2	7.2%	0.0%	1.2	16.7%	0.0%
Foreign exchange	0.6	3.3%	0.0%	0.3	4.6%	0.0%
Other	2.0	11.3%	0.1%	1.5	21.3%	0.0%
Total	17.4	100.0%	0.5%	7.0	100.0%	0.2%

Non-interest income, which comprises all revenues other than net interest income increased by $10.4 million or 148.3% to $17.4 million in 2019.

Increase is primarily due to gain on sale of DUCA's head office building ($6.9 million), multi-unit residential buildings ("MURB") securitization income ($1.7 million) and higher commercial loan and wealth management fee income.

The Credit Union securitizes and sells mortgage-backed securities of certain insured multi-unit residential mortgages with no prepayment of credit risk associated with the sold mortgage-backed securities. The outstanding balances were $183 million for the year ended December 31, 2019 (2018 – Nil).

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

Provision for Credit Losses

The following table presents the carrying amount of loans by portfolio and the balance of their respective ECL allowance as at December 31, 2019 (In thousands of Canadian dollars):

	Stage 1		Stage 2		Stage 3		Total	
	Gross carrying amount $	ECL allowance $	Gross carrying amount $	ECL Allowance $	Gross carrying amount $	ECL allowance $	Gross carrying amount $	ECL allowance $
Residential mortgages	2,430,793	1,232	87,257	690	2,486	231	2,520,536	2,153
Commercial loans	809,611	2,189	142,599	689	5,384	582	957,594	3,460
Personal loans	17,256	85	496	37	19	11	17,771	133
Total	3,257,660	3,506	230,352	1,416	7,889	824	3,495,901	5,746

The following table presents the carrying amount of loans by portfolio and the balance of their respective ECL allowance as at December 31, 2018 (In thousands of Canadian dollars):

	Stage 1		Stage 2		Stage 3		Total	
	Gross carrying amount $	ECL allowance $	Gross carrying amount $	ECL Allowance $	Gross carrying amount $	ECL allowance $	Gross carrying amount $	ECL allowance $
Residential mortgages	2,007,471	1,036	55,834	322	543	36	2,063,848	1,394
Commercial loans	832,836	2,664	83,040	1,447	5,835	779	921,711	4,890
Personal loans	11,569	60	441	47	47	25	12,057	132
Total	2,851,876	3,760	139,315	1,816	6,425	840	2,997,616	6,416

The Credit Union's recovery of credit losses was ($0.5) million for the year ended December 31, 2019 compared to ($0.3) million for the prior year.

The Credit Union uses a 10-point risk rating model to measure and manage its exposure on its commercial loan portfolio. The 10-point rating scale ranges from Substantially Risk Free (1) to Unacceptable/Impaired Risk (10). A risk rating of 6 or below is deemed to be acceptable risk for new loans.

The Credit Union uses the "Equifax Beacon score" as one benchmark to manage the risk of the retail portfolio. Equifax is a global information solution company that provides credit scores. A credit score is one measure on how likely a person is to repay a loan. DUCA's risk rating ranges across three bands: above standard, standard and below standard. For Members who have Beacon scores below standard, DUCA has lending programs that assist Members who are in need of credit, notwithstanding the Beacon score. These loans are priced accordingly based on risk profile.

The following table sets out the Credit Union's credit risk exposure for all loans carried at amortized cost as at December 31, 2019. Stage 1 represents those performing loans carried with a 12-month ECL, Stage 2 represents those performing loans carried with a lifetime ECL, and Stage 3 represents those loans with a lifetime ECL that are credit impaired.

(In thousands of Canadian dollars)	**Stage 1** $	**Stage 2** $	**Stage 3** $	**Total** $
Residential				
Above standard	**1,627,157**	**2,171**	**960**	**1,630,288**
Standard	**703,048**	**35,338**	**597**	**738,983**
Below standard	**100,588**	**49,748**	**929**	**151,265**
	2,430,793	**87,257**	**2,486**	**2,520,536**
Commercial				
Above standard	**181,997**	**399**	**—**	**182,396**
Standard	**626,826**	**18,609**	**4,712**	**650,147**
Below standard	**788**	**123,591**	**672**	**125,051**
	809,611	**142,599**	**5,384**	**957,594**
Personal				
Above standard	**12,631**	**67**	**—**	**12,698**
Standard	**4,140**	**203**	**6**	**4,349**
Below standard	**485**	**226**	**13**	**724**
	17,256	**496**	**19**	**17,771**
	3,257,660	**230,352**	**7,889**	**3,495,901**

The following table sets out the Credit Union's credit risk exposure for all loans carried at amortized cost as at December 31, 2018. Stage 1 represents those performing loans carried with a 12-month ECL, Stage 2 represents those performing loans carried with a lifetime ECL, and Stage 3 represents those loans with a lifetime ECL that are credit impaired.

(In thousands of Canadian dollars)	Stage 1 $	Stage 2 $	Stage 3 $	Total $
Residential				
Above standard	1,397,376	2,158	—	1,399,534
Standard	550,355	21,184	346	571,885
Below standard	59,740	32,492	197	92,429
	2,007,471	55,834	543	2,063,848
Commercial				
Above standard	165,822	230	—	166,052
Standard	666,087	2,893	9	668,989
Below standard	927	79,917	5,826	86,670
	832,836	83,040	5,835	921,711
Personal				
Above standard	6,801	16	1	6,818
Standard	4,427	168	35	4,630
Below standard	341	257	11	609
	11,569	441	47	12,057
	2,851,876	139,315	6,425	2,997,616

As at December 31, 2019, 94% of outstanding commercial loans are risk rated 6 or less (2018 – 90%) based on the Credit Union's risk rating model.

Note 7 to the Financial Statements has additional disclosures with respect to the allowance for credit losses, the movement of ECLs, the portfolio rating of loans by Above Standard, Standard and Below Standard and delinquency aging analysis.

Non-Interest Expense

($ millions)	2019			2018		
	Expense	Mix	% of average assets	Expense	Mix	% of average assets
Salaries and benefits	29.2	53.1%	0.8%	22.4	54.7%	0.7%
Occupancy	2.5	4.6%	0.1%	3.5	8.6%	0.1%
Depreciation and amortization	3.3	5.9%	0.1%	1.5	3.7%	0.0%
Deposit insurance	2.2	3.9%	0.1%	1.7	4.2%	0.1%
Directors and committees	0.4	0.7%	0.0%	0.5	1.1%	0.0%
Loss on derivative instruments	0.0	0.0%	0.0%	1.0	2.4%	0.0%
Other operating and administrative expenses						
Technology	5.0	9.0%	0.1%	3.6	8.9%	0.1%
Professional fees	3.8	6.9%	0.1%	2.7	6.7%	0.1%
Marketing	3.6	6.6%	0.1%	3.0	7.4%	0.1%
Administration	2.6	4.7%	0.1%	2.0	4.9%	0.1%
Central 1 and bank charges	1.2	2.2%	0.0%	1.0	2.4%	0.0%
Donations	0.5	1.0%	0.0%	0.4	1.0%	0.0%
Legal accruals	0.0	0.0%	0.0%	-2.0	-4.8%	-0.1%
Other expenses	0.7	1.2%	0.0%	0.4	1.0%	0.0%
Total Other operating and administrative expenses	17.4	31.6%	0.5%	11.2	27.4%	0.4%
Total	54.9	100.0%	1.5%	40.9	100.0%	1.3%

Total non-interest expenses in 2019 were $54.9 million, up $14.0 million or 34.2% from the prior year.

The CER was 82.7% compared to 72.1% for the years ended December 31, 2019 and 2018, respectively. The increase was primarily attributable to the increase in non-interest expense, focused on investment to support planned growth and development of the Credit Union.

Salaries and benefits were $29.2 million, up $6.8 million or 30.4% from the prior year. Overall full-time equivalent (“FTE”) employees were 303, up 53 FTEs or 21.2% from the prior year.

From January 1, 2019, leases are recognized as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the Credit Union. Each lease payment is allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The right-of-use asset is depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis.

Occupancy costs, which included rent expense, were $2.5 million, down $1.0 million or 28.5% from the prior year as a result of the adoption of IFRS 16. Depreciation and amortization expenses were $3.3 million, up $1.8 million from the prior year primarily as a result of IFRS 16 and investments in technology and branch refurbishments. Interest expense was $0.2 million due to the recognition of lease liabilities as a result of IFRS 16.

Technology costs increased to $5.0 million, up $1.4 million or 38.9% from 2018. During 2019, DUCA incurred higher cost for technology development as well as licensing fees and software development for other applications.

Marketing costs increased to $3.6 million, up $0.6 million or 20.0% from 2018 due to a continued focus on

DUCA's digital marketing strategy, brand marketing and the Earn More Savings Deposit campaigns.

Financial Condition Review

Total assets were $4.056 billion at December 31, 2019 compared with $3.374 billion at the end of 2018 and up 20.2% for the year as a result of higher loan and investment balances.

DUCA's loan growth during 2019 was $498.3 million resulting in an increase in loan balances of 16.6% from 2018's loan balances of $2.998 billion.

Residential mortgage balances increased by $456.7 million or 22.1% (2018 - $628.3 million, 43.8%). DUCA's branch and proprietary mortgage specialist channels grew $214.2 million compared with $69.5 million in 2018. Originations through its mortgage broker channel was $242.5 million compared with $558.7 million in 2018.

Our commercial loan balances increased by $35.9 million or 3.9%. The commercial finance team has been managing down certain large commercial credit exposures and new loan origination has been rebalanced to be less reliant on large commercial and land transactions.

Total loans in arrears greater than 30 days increased to $11.8 million (34 basis point of the total Members' loans) at the end of 2019 compared with $7.2 million at December 31, 2018 (24 basis point of the total Members' loans).

Investments, third-party mortgages, mortgage pools, Cash and cash equivalents totaled $510.5 million at December 31, 2019, up from $351.3 million in 2018. This increase was primarily due to higher levels of investment balances in third-party mortgages and mortgage pools as at December 31, 2019.

Member deposits increased to $2.980 billion at December 31, 2019, up $441.1 million or 17.4% from 2018. The increase in Member deposits is largely attributable to the Earn More Savings campaign during 2019.

DUCA continued its program of securitizing residential mortgages though Canada Mortgage and Housing Corporation ("CMHC") National Housing Act Mortgage-Backed Securities (NHA MBS) and Canada Mortgage Bond ("CMB") Programs. Securitizing mortgages is an additional funding mechanism and allows DUCA the opportunity to obtain funding at attractive rates compared to other sources, as well as matching the maturity terms of the underlying mortgages.

Securitization balances decreased to $583.2 million, down $50.2 million or 7.9% from the prior year as a result of lower levels of insurable mortgages originated by the Credit Union resulting from changes in insurance eligibility guidelines.

A comprehensive credit facility is maintained with a major Canadian chartered bank up to a maximum of $14 million and is secured by bank deposit notes totaling $10 million (2018 – 10 million) (notes 4 and 5). The Credit Union has an unused credit facility of $14 million (2018 – $14 million) at year-end.

A line of credit is maintained with Central 1 up to a maximum of $130 million and is secured by a general security agreement covering all the assets of the Credit Union. The Credit Union has an unused credit facility of $100 million (2018 – $130 million) at year-end, of which $50 million is prescribed for the guarantee of payment on third party Municipalities, Universities, School Boards and Hospitals deposits with the Credit Union as agreed to by Central 1 and $14.5 million is prescribed towards letters of credit issued on behalf of the Credit Union.

The Credit Union entered into an agreement with Mercury Receivables Trust on April 16, 2019, which gives the Credit Union access to a $100 million credit facility, which is secured by a pool of $191 million uninsured mortgages. Central 1 provides a Performance Guarantee on the drawn amount of the credit facility funded volume. As at December 31, 2019, the Credit Union has an unused credit facility of $95 million.

On March 4, 2019, the Credit Union entered into The Bond Market Association/International Securities Market Association 2000 Version Global Master Repurchase Agreement with National Bank Financial Inc., which gives the Credit Union access to an uncommitted $50 million credit facility where the Credit Union can access borrowing on a short-term basis by pledging mortgage-backed securities that they are holding for liquidity.

A line of credit facility is maintained with Desjardins up to a maximum of $160 million (2018 – $125 million) and is secured by a pledge of residential mortgages. The Credit Union has an unused credit facility of $62 million (2018 – $125 million) at year-end.

Regulatory capital was $296.7 million at December 31, 2019 up from $180.8 million at December 31, 2018 driven by issuance of Class B Series 4 shares.

DUCA's Leverage ratio was 7.3% at the end of 2019 compared with 5.4% at the end of 2018 and exceeds the minimum of 4.0% stipulated in the Credit Unions and Caisses Populairies Act, 1994 (the "Act").

DUCA's regulatory risk-weighted capital ratio was 16.5%, up 468 basis points from 11.8% at the end of 2018, higher than the minimum of 8.0% stipulated in the Act.

Provincial Regulations also require at least 50.0% of a credit union's capital base be comprised of Tier 1 capital. As at December 31, 2019, DUCA's Tier 1 capital represented 85.6% (2018 – 75.0%) of the overall capital base, well in excess of the minimum requirement.

Wealth assets under management increased from $223.3 million at year-end 2018 to $317.0 million at December 31, 2019. Wealth assets include Mutual Funds, Stocks and Bonds offered through an arrangement with Aviso Wealth as at December 31, 2019.

Dividends

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

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

($ millions)	**2019**	**2018**	**2017**	**2018**	**2017**	**2016**
Patronage return	1.4	1.2	1.2	1.4	1.2	1.2
Class A shares dividend	0.8	0.8	-	0.8	-	0.9
Class B shares dividend	1.2	1.2	1.3	1.2	1.3	-

During 2019, the Board of Directors declared a patronage return of 2.0% (2018 – 2.0%) consisting of bonus interest on Members' deposits and loans. On February 28, 2019, the Board of Directors declared a dividend of 3.5% on the outstanding amount of the Class B shares and a dividend of 2.0% on the outstanding amount of Class A shares to the holders of record at December 31, 2018. The dividends were paid on March 1, 2019.

On February 28, 2020, the Board of Directors declared a dividend of 3.5% on the outstanding amount of the Class B shares and a dividend of 2.0% on the outstanding amount of Class A shares to the holders of record at December 31, 2019. The dividends were paid on March 2, 2020.

Capital Management

DUCA is committed to a disciplined approach to capital management and maintaining a strong capital base to support the risks associated with its business activities. At all times, DUCA adheres to capital regulatory requirements prescribed by the Financial Services Regulatory Authority of Ontario ("FSRA")

DUCA's capital management philosophy is to maintain a prudent cushion of equity to ensure ongoing economic stability as well as finance new growth opportunities.

DUCA's capital management framework establishes and assigns the responsibilities related to capital and sets forth both general and specific policy guidelines related to capital management and the reporting mechanisms.

DUCA's Capital Management is a key accountability of the Board of Directors (the "Board") of DUCA. The Board provides oversight and approval of capital management, including the capital plan included in the Annual Operating Plan ("AOP"). The Board regularly reviews DUCA's capital position and key capital management activities.

DUCA's capital requirements are provincially regulated and monitored by FSRA for both the minimum regulatory capital and the risk weighted capital approach developed by the Bank for International Settlements ("BIS"). FSRA established a minimum capitalization of 4.0% based as a percentage of assets and a minimum capitalization of 8.0% based on a ratio of capital to risk-weighted assets. In addition, at least 50.0% of a credit union's capital base, for meeting the standard, must consist of primary or Tier 1 capital that includes voting share capital, qualifying investment shares, contributed surplus, retained earnings, less intangible assets such as goodwill and deferred income tax assets.

The Credit Union maintains an internal policy that total Members' capital as shown on the statement of financial position shall not be less than 5.00% (2018 – 4.75%) of the book value of all assets and 10.50% (2018 – 10.50%) of risk-weighted assets.

At December 31, 2019, DUCA's Leverage ratio was 7.3% (2018 – 5.4%), the risk weighted capital ratio was 16.5% (2018 - 11.8%) and the Tier 1 ratio to total capital was 85.6% (2018 – 75.0%).

Capital levels are monitored monthly based on our forecasted financial position, on both capital leverage and risk weighted basis. DUCA's monitoring and forecasting procedures track the expected growth rate in both assets and risk-weighted assets relative to earnings to determine if additional capital is required. These projections also take full account of any future impact of changes in accounting standards.

Risk Management

The Board is accountable for the risk appetite of the Credit Union and for overseeing the Credit Union's management of its principal risks. While the Board delegates accountability for the development and implementation of risk policies and procedures to the Chief Executive Officer ("CEO"), it retains responsibility for ensuring that these policies and procedures remain adequate and comprehensive and that the Credit Union follows them.

Included in this policy are DUCA's Risk Appetite Statements ("RAS") and Enterprise Risk Management Framework ("ERMF") which are integral parts of the Credit Union's overall ability to effectively manage risks. The RAS and ERMF involve the interaction of risk-related activities including oversight, risk assessment, risk quantification, monitoring, reporting, escalation, and risk controls.

DUCA's risk taking activities are undertaken with the understanding that risk taking, and effective risk management are necessary and integral to achieving strategic objectives and managing business operations. However, above all, risk taking activities are guided by the Credit Union's overarching objective of safeguarding commitments made to its Members and stakeholders.

DUCA's ERMF Policy reflects the following risk philosophy:

- DUCA's strategic objectives are established by balancing the requirement to safeguard the commitments the Credit Union has made to its Members and stakeholders, while generating an appropriate risk-adjusted return for our Members;

- The Risk Management function will be part of the management of the Credit Union with risk analysis and risk reporting forming part of the regular activities and on-going responsibility of all those who make decisions;

- All employees are to base business decisions on an understanding of the risk that will be accepted. This applies to transactions, products, planning, relationships with Members or suppliers and any other business activities. Risk management is about how DUCA makes decisions and ensures that all decision makers consider the potential impacts (positive or negative) of those decisions;

- All business activities will align with our Mission, Vision, Values, Code of Conduct and Policies;

- Providing financial services inherently involves the assumption of risk. On this basis, DUCA's business strategy, the effective management and acceptance of risk, and its related risk appetite are closely linked and integral components in business decision making;

- Business strategy choices are evaluated based on appropriate risk/return trade-offs, the serving of Members' best interests and satisfying needs of stakeholders. At the same time, strategic choices must fit within the Credit Union's risk appetite, which also is formulated based on serving Member best interests, satisfying needs of stakeholders, and the appropriate understanding and management of risks;

- The organization will maintain a culture that encourages all staff and the Board to be involved in open, honest, timely and critical discussions of risk;

- DUCA will develop and use a standard set of tools to assist in the identification, analysis, evaluation and reporting of risk.

The Credit Union's Board is accountable for the oversight of risk management that is centered on the "three lines of defense" model:

- 1st Line of Defense – DUCA's first line of defense includes the CEO and business managers. Businesses are ultimately responsible for the risks they assume and for the day-to-day management of the risks inherent in the product, activities, processes, and systems for which they are accountable as well as the execution of risk mitigation practices consistent with risk appetite. Various committees are in place to oversee the day-to-day management of risk.

- 2nd Line of Defense – DUCA's second line of defense consists of the Chief Risk Officer and the Risk Management function. This group provides oversight of risk taking and risk mitigation activities across the enterprise. The Management Risk and Asset Liability Committee ("MRALCO") also provides support to the Executive Leadership Team "(ELT") for overseeing enterprise-wide risk taking and risk mitigation activities.

- 3rd Line of Defense - The third line of defense consists of Internal and External Audits which provide independent assurance that controls are effective and appropriate relative to the risks inherent in the business and that risk mitigation programs and risk oversight functions are effective in managing risks.

Identification and Management of Key Risks

The identification, assessment and management of risk are critical elements of DUCA's ERMF program, both on a day-to-day basis as well as when any new business initiative or activity is undertaken. DUCA manages these risks as part of its risk management activities through the MRALCO.

Our ERMF defines and categorizes risk as outlined below:

Credit Risk	Operational Risk	Capital, Liquidity, and Market Risk	Strategic Risk	Compliance Risk

Credit Risk

Credit risk is the risk of financial loss when a Member or counterparty to a financial instrument fails to meet the contractual obligations of repayment and arises principally from the loan portfolio. DUCA's lending philosophy is established by the Credit Risk Management Policy ("CRMP"). The CRMP provides direction to management relative to:

- Formulating operational credit policies covering eligible purposes of loans, collateral requirements, credit assessment, risk rating and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements;
- Establishing a lending authority structure for the approval and renewal of credit facilities;
- Authorization limits are delegated to the Management Credit Committee ("MCC"), Chief Risk Officer and Risk Management personnel;
- Reviewing and assessing specific and aggregate credit risk;
- Limits in concentrations of exposure to counterparties;
- Compliance with agreed exposure limits. Monthly reports are provided to the MCC and to the Board on the quality of the loan portfolio.

Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed human performance, processes or technology. DUCA is exposed to a broad range of operational risks including talent acquisition, retention, performance and succession, technology/systems failures, fraud/theft/misappropriation of assets, business disruption, information/privacy/fiduciary breaches or failed transaction processing. The failure to manage operational risk can result in direct or indirect financial loss, reputational impact, regulatory censure and penalties, or failure in the management of other risks.

DUCA manages operational risk through its policies, procedures and internal controls related to human resources, information technology development and change management and business operations. Complementing these policies, procedures and internal controls, are teams that focus on the enterprise-wide management of specific operational risks such as financial crime, business continuity/disaster recovery, privacy and confidentiality, vendor management, project management, and information security and information technology governance. These teams have developed specific programs, policies, standards and methodologies to support the management of operational risk.

Capital, Liquidity and Market Risk

1. Capital Risk

   The Internal Capital Adequacy Assessment Process ("ICAAP") provides a framework for evaluating and determining the amount of capital required to manage through unexpected losses arising from adverse economic and operational conditions. Modelling and stress testing, applied to both near- and longer-term planning, forecasting and strategic objectives, is a key component of the ICAAP. The ICAAP includes: calculation of required capital levels based on the financial plan for the upcoming fiscal year, application of stress testing related to key identified risks using sensitivity analysis to determine capital impacts under different scenarios, assessment of internal capital targets for reasonableness relative to the regulatory capital requirements and projection of capital levels over multiple years. The ICAAP is reviewed, approved by the Board, and submitted to FSRA annually.

   Application of the ICAAP in 2019 confirmed that DUCA's capital levels are sufficient. The Credit Union does expect higher levels of asset growth in the future and will proactively manage its capital to ensure capital sufficiency on an ongoing basis.

2. Liquidity Risk

   Liquidity is the ability of a credit union to generate or obtain sufficient cash or its equivalents in a timely manner at a reasonable price to meet its commitments as they fall due. Liquidity risk arises from a credit union's potential inability to meet both expected and unexpected current and future cash flow and collateral needs without affecting daily operations or its financial condition. A credit union's obligations, and the funding sources used to meet them, depend significantly on its business mix, balance sheet structure, and the cash flow profiles of its on- and off-balance obligations. These include funding mismatches, market constraints on the ability to convert assets into cash or in accessing sources of funds, and contingent liquidity events, such as finding additional funds for undrawn loan commitments or replacing maturing liabilities.

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

The Credit Union agrees to maintain at least 6% of its assets on deposit with Central 1 to retain its Membership. As at December 31, 2019, 6.0% of the Credit Union's total assets was $243,387, which is included in both investments and cash and cash equivalents. At December 31, 2019, the Credit Union was compliant with this requirement.

Provisions of the Act require the Credit Union to maintain a prudent amount of liquid assets in order to meet Member withdrawals, which includes the Liquidity Coverage Ratio ["LCR"], Net Cumulative Cash Flow ["NCCF"], and Net Stable Funding Ratio ["NSFR"]. In addition, the Credit Union also maintains an Internal Liquidity Ratio ["ILR"].
The Credit Union manages liquidity risk by:

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

The LCR is a measure that aims to ensure that the Credit Union has an adequate stock of unencumbered high quality liquid assets ["HQLA"] that can be converted into cash at little or no loss of value, to meet its liquidity needs for a 30-calendar day liquidity stress scenario. At a minimum, the stock of unencumbered HQLA should enable the institution to survive until day 30 of the stress scenario, by which time it is assumed that appropriate corrective actions can be taken by Management. DUCA's LCR at December 31, 2019 was 223% (2018 - 1,620%) compared with a regulatory minimum of 100%. The decrease in LCR is mainly due to $550 million High Interest Savings Promotion accounts which matured on January 31, 2020.

The NCCF is a liquidity metric that measures the Credit Union's survival horizon based on its net cumulative cash flows. It identifies potential future funding mismatches between contractual inflows and outflows for various time bands over and up to a 12-month time horizon. DUCA's NCCF at December 31, 2019 was 110% (2018 - 266%) coverage over 12 months compared with a policy minimum of 100% coverage over 12 months.

The NSFR is a standard that will require credit unions to maintain a stable funding profile in relation to the composition of their assets and off-balance sheet activities. A sustainable funding structure is intended to reduce the likelihood that disruptions to a credit union's regular sources of funding will erode its liquidity position in a way that would increase the risk of its failure and potentially lead to broader systemic stress. The NSFR aims to limit over-reliance on short-term wholesale funding, encourages better assessment of funding risk across all on- and off-balance sheet items, and promotes funding stability. DUCA's NSFR at December 31, 2019 was 167% (2018 -167%) compared with a regulatory minimum of 100%.

In addition, DUCA has an ILR metric to ensure that the Credit Union has an adequate stock of unencumbered HQLA that can be converted into cash at little or no loss of value, to meet its liquidity needs based on total deposits and borrowings. DUCA's ILR at December 31, 2019 was 12.2% (2018 - 16.70%) compared with a policy minimum of 10%.

3. Market Risk

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

[i] Interest rate risk

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

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

The Credit Union's interest rate risk position is measured monthly. Measurement of risk is based on rates charged to Members, as well as rates paid to depositors. Schedules of matching and interest rate vulnerability are regularly prepared and monitored by Credit Union Management and reported to FSRA in accordance with the Credit Union's policy. This policy has been approved by the Board of Directors and filed with FSRA by Credit Union regulations. For the year ended December 31, 2019 and December 31, 2018, the Credit Union was in compliance with this policy.

[ii] Currency risk

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

The Credit Union's currency risk position is measured daily. Measurement of risk is based on rates charged to clients, as well as currency purchase costs. The Credit Union's exposure to changes in currency exchange rates shall be controlled by limiting the unhedged foreign currency exposure to the lesser of $1,000 or 5% of total Member foreign currency deposits in Canadian funds. For the year ended December 31, 2019, the Credit Union's exposure to foreign exchange risk is within policy.

[iii] Equity risk

Equity risk is the uncertainty associated with the valuation of assets arising from changes in equity markets. The Credit Union is exposed to this risk through its equity holdings.

The Credit Union's portfolio includes unlisted Canadian and U.S. stocks, comprising investments in Central 1 and SoFi. The total investment in preferred shares and dividend-bearing equities cannot exceed the lesser of $15,000 or 1% of assets, excluding the Credit Union's investment in Central 1 and SoFi. For the year ended December 31, 2019, the Credit Union's exposure to equity risk is within policy.

Strategic Risk

Strategic risk is the risk that DUCA is unable to identify and adapt to changes in the business environment and/or is unable to implement appropriate business plans and strategies.

DUCA manages its strategic risk through its strategic planning process. The ELT, led by the CEO is responsible for developing and recommending strategies and operational plans, which address key industry, competitive, and consumer trends as well as the Credit Union's key areas of strength and limitation. Strategies and plans are developed by the ELT to align with the overarching strategic direction set by the Board. To set direction and review progress, the Board provides input to, approves, and reviews annual strategic and operational plans, and evaluates performance toward goals and objectives.

Compliance Risk

Compliance risk is exposure to legal penalties, financial forfeiture and material loss DUCA could incur when it fails to act in accordance with industry laws and regulations or internal policies.

In many cases, compliance risk results from inadequate controls or issues related to training, due diligence and human error. Compliance capabilities, processes, practices and training can be a significant challenge and cost.

While the ELT is responsible for ensuring compliance on issues related to products and services, transactions, sales and service practices and new and existing business activities, all DUCA employees are responsible for protecting DUCA's reputation and ensuring compliance with applicable laws, regulations, and standards.