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2021 Management's Discussion & Analysis

Management's Discussion & Analysis

This Management's 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, 2021, as compared to December 31, 2020. 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"). 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.

Impact of COVID-19

In mid-March 2020, the World Health Organization officially declared the outbreak of COVID-19 to be a global pandemic, leading to profound and unprecedented disruptions to economies around the world as governments implemented measures to contain the spread of the virus, such as temporary closures of non-essential businesses, social distancing protocols and travel restrictions. To help mitigate the impact of these disruptions, a number of financial relief programs were introduced by governments and financial institutions, including credit unions.

While the initial wave of COVID-19 infections subsided in the late spring of 2020, by the end of 2020 new reported infections reached levels warranting restrictions similar to those introduced at the onset of the pandemic throughout much of Canada. This second wave was followed by a third wave during the first quarter of 2021 and was attributed to the rise of variants of the virus that were believed to be more contagious, which prompted restrictions to tighten significantly to limit the spread of the virus. While the first COVID-19 vaccinations were approved in Canada at the end of 2020, rollout in Canada did not pick up momentum until mid-2021, leading to a substantial reduction of new infections and hospitalizations as well as supporting government decisions to begin easing restrictions. Despite a fourth wave of infections emerging in the third quarter of 2021 due to the highly contagious nature of the Delta variant, continued success of vaccine distribution helped to keep hospitalizations at a manageable level and contributed to an improved economic outlook. However, the Omicron variant which emerged in the fourth quarter, has triggered a fifth wave of infections and the reintroduction of government measures to limit the spread of the virus casting continued uncertainty as of the end of 2021 with respect to the ultimate duration of the pandemic and its impact on the economy.

Since the pandemic was declared in March 2020, DUCA continued to operate under health guidelines established by the Province of Ontario and relevant local public health units throughout 2020 and 2021. All operational decisions have revolved around the desire to preserve the health and safety of DUCA’s Members and Employees while facilitating uninterrupted delivery of our essential services through Branches and Member Connect teams. DUCA continued to take measures to ensure that nearly all non-Member-facing Employees were able to work remotely and maintain normal business functions. For those Employees who were required to work in Branches or at the head office, DUCA made a number of changes to its physical space, as well as policies and procedures to allow for appropriate social distancing, protection and sanitization.

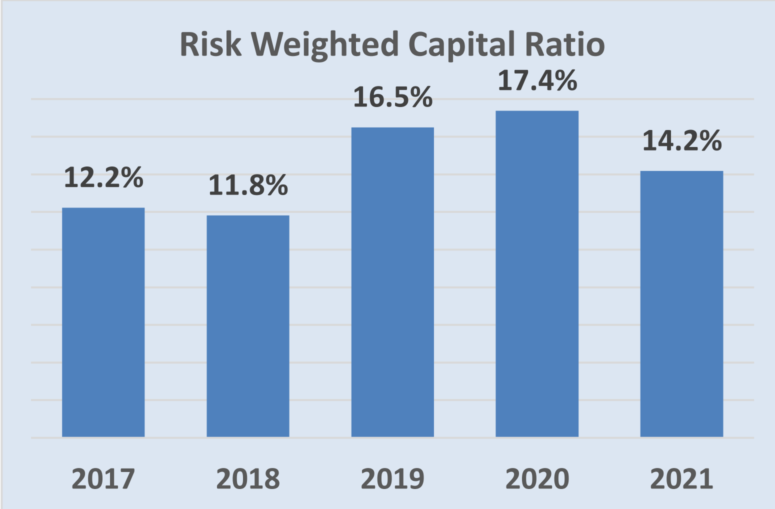
As at year end December 31, 2021, planning was underway to open access to its head office on a limited and voluntary basis in 2022, in anticipation of a gradual lifting of health and safety restrictions. DUCA’s teams remain fully operational and able to support Member needs. The health and safety of DUCA’s Members, Employees and business partners remains the top priority in all operational decisions.

Initially, a significant impact of the COVID-19 pandemic on the Credit Union’s financial results was the increase in ECL in the first half 2020, reflecting the impact of the pandemic on the forward-looking macroeconomic assumptions used in the ECL models. During 2021, higher ECL did not materialize and subsequent improvements in forward-looking assumptions, complemented by continued strong credit quality of the loan portfolio resulted in decreases in ECL, reversing most of the provisions recorded in 2021. However, a high degree of uncertainty remains with respect to the continuing impact of the pandemic and there may be future volatility in ECL. Please see the Provision for Credit Losses section of this MD&A for information on the change in ECL recognized during the year.

Financial Results Highlights

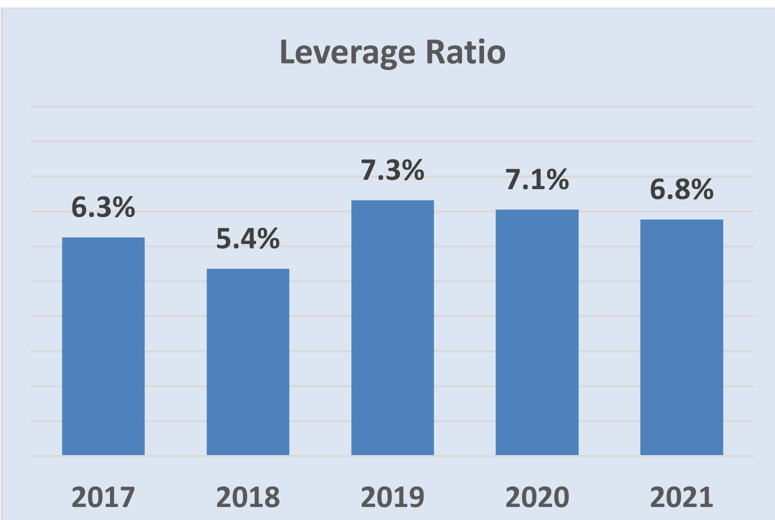
- Net income for the year ended December 31, 2021 was $25.7 million compared to $12.8 million for the year ended December 31, 2020.
- Income before patronage and tax for the year ended December 31, 2021 was $31.7 million compared to $17.3 million for the year ended December 31, 2020.
- Interest income of $169.1 million for the year ended December 31, 2021 was up by $9.1 million, or 5.7%, year over year. Interest expense of $84.8 million for the year ended December 31, 2021 was down by $8.4 million, or 9.0%, year over year. Net interest income of $84.3 million for the year ended December 31, 2021 was up by $17.5 million, or 26.2%, year over year, primarily driven by loan growth and lower funding costs.
- The provision for credit losses for the year ended December 31, 2021 was $37 thousand compared to $1.3 million for the year ended December 31, 2020. This was primarily driven by more favourable forward-looking macroeconomic data leading to a recovery of previous provisions taken as the economy gradually recovers from the pandemic.
- Non-interest expense of $67.0 million was $6.5 million, or 10.8%, higher than the prior year primarily driven by investments made by the Credit Union to support planned growth.
- Return on average equity ("ROE") was 7.4% for the year ended December 31, 2021 compared to 4.1% for the year ended December 31, 2020 driven by higher earnings.
- Total assets were $5.52 billion at December 31, 2021 compared with $5.11 billion at the end of 2020 and up 8.0% year over year driven primarily by Member loan growth.
- Assets under administration, which include off-balance sheet wealth management assets, were $6.03 billion compared with $5.48 billion in 2020, up 9.9% year over year.
- Gross Member loans increased to $4.83 billion, up 17.4% from $4.11 billion at the end of 2020.
- Gross Member deposits increased to $4.53 billion, up 18.9% from $3.81 billion at the end of 2020.
- Securitization liabilities decreased to $463.2 million, down 33.6% from $698.1 million at the end of 2020.
- In 2021, DUCA returned to its Members $1.5 million and $0.7 million in the form of profit-sharing Class A patronage and dividends, respectively. Cumulatively, since 1999, DUCA has returned over $80.5 million to its Members in profit-sharing Class A patronage and dividends.[1]
- DUCA paid $1.2 million in dividends to holders of Class B Series 1 investment shares in 2021, and $6.3 million cumulatively since 2017.[1]
- DUCA paid $7.3 million in dividends to holders of Class B Series 4 investment shares in 2021.[1]
- The leverage ratio was 6.8% at December 31, 2021 compared with 7.1% at the end of 2020. The regulatory minimum requirement is 4.0%.
- The risk-weighted capital ratio was 14.2% at December 31, 2021 compared with 17.4% at December 31, 2020. The regulatory minimum requirement is 8.0%.

[1] During 2021, the Board of Directors declared a profit-sharing patronage return of 1.0% consisting of bonus interest on Members' deposits and loans, which was subsequently paid in March 2022. Subsequent to year-end, on March 1, 2022, the Board of Directors declared a dividend of 3.0% on the outstanding amount of the Class B Series 1 investment shares, a dividend of 4.25% on the outstanding amount of the Class B Series 4 investment shares, and a dividend of 2.0% on the outstanding amount of profit-sharing Class A shares to the holders of record as at December 31, 2021. The dividends were subsequently paid in March 2022.



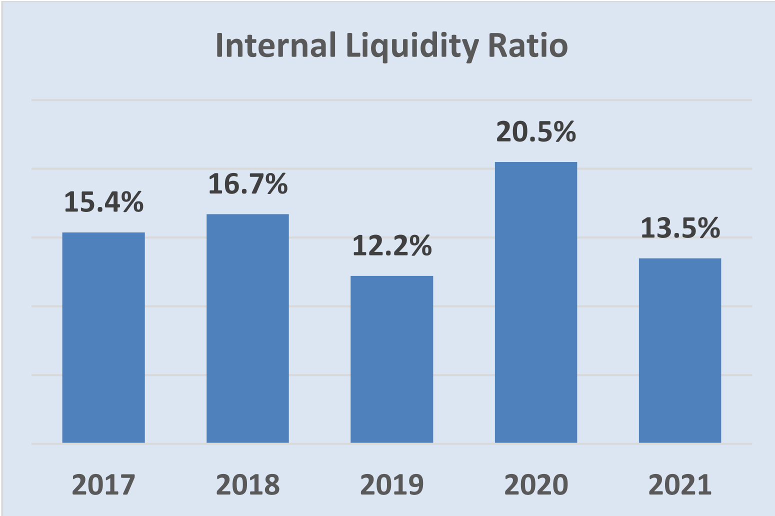
The **Risk-Weighted Capital Ratio** is the ratio of regulatory capital divided by risk-weighted assets ("RWA"), expressed as a percentage. RWA is the sum of the absolute value of assets in specified categories multiplied by a corresponding percent, varying between 0% and 100% depending on the risk attributed 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%. As at December 31, 2021, the risk-weighted capital ratio was 14.2% compared with 17.4% in the prior year.



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

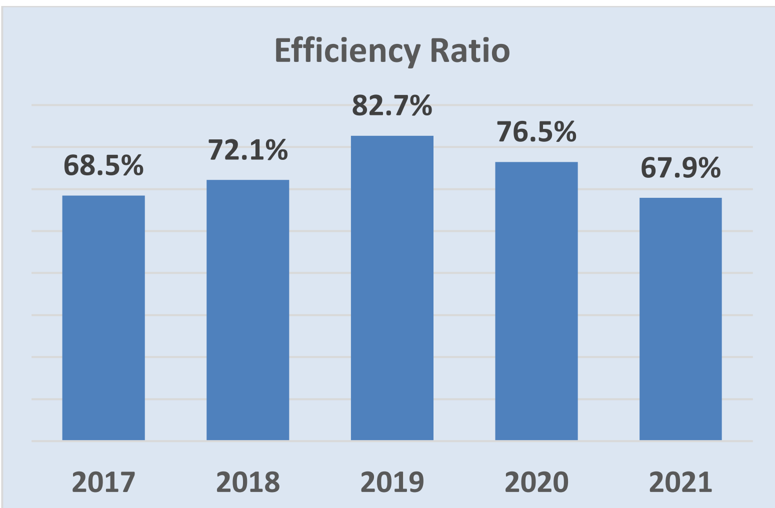
FSRA requires a minimum leverage ratio of 4.0%. DUCA's Board of Directors has established a minimum leverage ratio of 5.0%. The leverage ratio was 6.8% at December 31, 2021 compared with 7.1% in 2020.



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

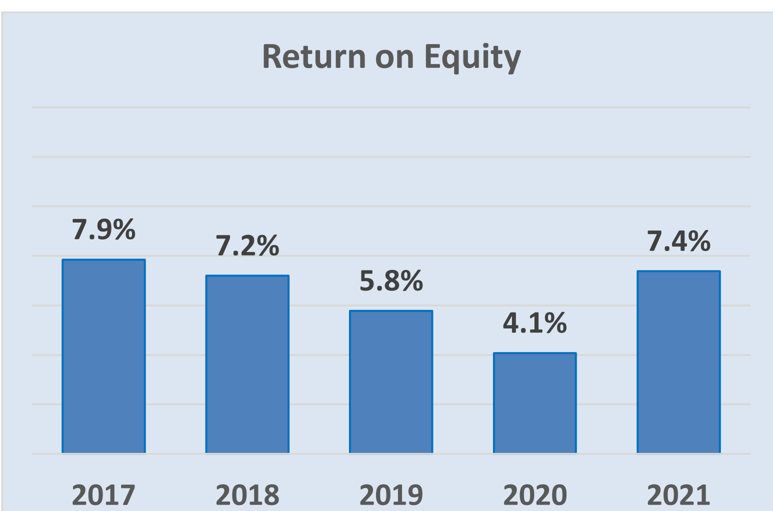
DUCA's policy requires the ILR to be a minimum of 10.0%. As at December 31, 2021, the ILR was 13.5% compared with 20.5% in the prior year.

FSRA requires the Credit Union to comply with additional liquidity metrics, which are discussed on pages 21 – 23.



The **Efficiency Ratio** (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 Efficiency Ratio was 67.9% for the year ended December 31, 2021, down from 76.5% in the prior year.

Net interest income and non-interest income increased by $19.6 million to $98.7 million and non-interest expenses increased by $6.5 million to $67.0 million. The increase in non-interest expense was driven by investments made to support planned growth of DUCA.



ROE is calculated as net income before patronage as a percentage of average Members' equity.

DUCA's ROE was 7.4% during 2021 compared to 4.1% in 2020.

2021 Financial Performance Review

Net Interest Income

Net interest income is composed of earnings on assets, such as loans and securities, less interest expense paid on liabilities, such as deposits and securitizations.

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

($ millions)	2021				2020			
	Average Balance	Interest	Mix	Rate	Average Balance	Interest	Mix	Rate
Cash equivalents and investments	680.8	11.0	13.1%	1.6%	733.7	16.2	15.7%	2.2%
Personal loans	53.1	1.7	1.0%	3.1%	20.9	0.8	0.4%	3.9%
Residential mortgages	3,315.9	103.6	63.7%	3.1%	2,918.1	94.0	62.5%	3.2%
Commercial loans	1,066.6	52.8	20.5%	4.9%	928.0	49.0	19.9%	5.2%
Other	86.9	-	1.7%		68.6	-	1.5%	
Total assets	5,203.3	169.1	100.0%	3.3%	4,669.3	160.0	100.0%	3.4%
Deposits	4,219.2	70.3	81.1%	1.7%	3,458.3	75.9	74.1%	2.2%
Borrowings & securitization	604.0	14.5	11.6%	2.4%	833.5	17.3	17.9%	2.1%
Other	20.3	-	0.4%		32.8	-	0.7%	
Total liabilities	4,843.5	84.8	93.1%	1.8%	4,324.6	93.2	92.6%	2.2%
Members' equity	359.8	-	6.9%		344.7	-	7.4%	
Total liabilities and Members' equity	5,203.3	84.8	100.0%	1.6%	4,669.3	93.2	100.0%	2.0%
Net interest income		84.3		1.7%		66.8		1.4%

Interest and investment income were $169.1 million for the year ended December 31, 2021 compared with $160.0 million for the year ended December 31, 2020. The increase of $9.1 million, or 5.7%, was primarily a result of loan growth. Average yields on assets were 3.3% for the year ended December 31, 2021 compared with 3.4% for the prior year due to continued market competitive pressure in mortgage products in 2021 which kept asset yields at low levels.

While the pandemic led to a decrease in interest rates, the impact on interest income has been partially offset by lower rates paid on deposits. Interest expense on deposits was $70.3 million for the year ended December 31, 2021 compared with $75.9 million for the prior year. The average rate of expense on deposits was 1.7% compared with 2.2% for the prior year.

Securitization and borrowing costs were $14.5 million, down $2.8 million, or 16.0%, due to lower levels of securitization balances during 2021 attributable to lower volumes of insurable loans and reduced borrowing activities throughout the year.

The overall net interest spread was 1.7% for the year ended December 31, 2021 compared with 1.4% for the year ended December 31, 2020.

Non-Interest Income

($ millions)	2021			2020		
	Income	Mix	% of average assets	Income	Mix	% of average assets
Securitization income	4.4	30.8%	0.1%	4.5	36.6%	0.1%
Wealth management	3.0	20.9%	0.1%	2.2	17.9%	0.0%
Gain on sale of property	2.1	14.3%	0.0%	-	0.0%	0.0%
Mortgage and loan fees	1.5	10.8%	0.0%	2.6	21.1%	0.1%
Service charges	1.5	10.3%	0.0%	1.3	10.6%	0.0%
Gain on sale of SoFi shares	0.7	4.6%	0.0%	-	0.0%	0.0%
Foreign exchange	0.4	2.7%	0.0%	0.3	2.4%	0.0%
Unrealized gain of investments	-	0.0%	0.0%	1.0	8.1%	0.0%
Other	0.8	5.6%	0.0%	0.4	3.3%	0.0%
Total	14.4	100.0%	0.3%	12.3	100.0%	0.3%

Non-interest income, which comprises all revenues other than net interest income, increased by $2.1 million, or 17.3%, to $14.4 million in 2021. The year-over-year increase is primarily due to a one-time gain on sale of DUCA's Rexdale branch in the amount of $2.1 million realized in 2021.

The Credit Union securitizes and sells mortgage-backed securities of certain insured MURB mortgages with no or little prepayment or credit risk associated with the sold mortgage-backed securities. The outstanding balance for these MURB mortgages were $1.12 billion as at December 31, 2021 (2020 – $668.9 million).

The Credit Union enters into certain transactions that 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, 2021 (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	3,549,236	409	63,585	108	4,942	96	3,617,763	613
Commercial loans	1,018,465	2,361	91,671	2,673	20,957	898	1,131,093	5,932
Personal loans	79,341	193	752	42	6	3	80,099	238
Total	4,647,042	2,963	156,008	2,823	25,905	997	4,828,955	6,783

The following table presents the carrying amount of loans by portfolio and the balance of their respective ECL allowance as at December 31, 2020 (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	3,060,257	716	41,837	162	3,107	71	3,105,201	949
Commercial loans	892,395	3,510	52,914	1,088	37,323	1,062	982,632	5,660
Personal loans	26,438	202	363	30	6	3	26,807	235
Total	3,979,090	4,428	95,114	1,280	40,436	1,136	4,114,640	6,844

As at December 31, 2021, the Credit Union’s ECL allowance for Members’ loans was $6.8 million (2020 – $6.8 million). The related provision for credit losses was $37 thousand for the year ended December 31, 2021 (2020 – $1.2 million), driven by more favourable forward-looking macroeconomic data leading to a recovery of previous provisions taken as the economy gradually recovers from the pandemic. The Credit Union’s investment in third-party mortgages and mortgage pools was presented net of ECL allowances of $0.1 million (2020 – $0.1 million) and the related recovery of credit losses was $37 thousand for the year ended December 31, 2021 (2020 – $0.1 million).

The Credit Union uses a 10-point risk rating model to measure and manage its exposure on its commercial loan portfolio. This risk rating model aligns with equivalent public debt ratings published by rating agencies. The 10-point rating scale ranges from Substantially Risk Free (1) to Unacceptable/Impaired Risk (10). A risk rating in the range of 1 to 6 is deemed to be acceptable risk for new loans.

The Credit Union uses the borrower’s credit score as one benchmark to manage the risk of the retail portfolio. A credit score is one measure on how likely a person is to repay a loan. DUCA’s risk ratings range across three bands: low risk, moderate risk and high risk. While DUCA generally originates retail loans with low to moderate risk, DUCA has lending programs that assist Members who are in need of credit, notwithstanding the borrower's credit score. These loans are priced accordingly based on risk profile.

The following table sets out the Credit Union's credit risk exposure for all Members' loans carried at amortized cost as at December 31, 2021. 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				
Low risk	1,865,900	—	—	1,865,900
Moderate risk	1,622,892	28,208	2,572	1,653,672
High risk	60,444	35,377	2,370	98,191
	3,549,236	63,585	4,942	3,617,763
Commercial				
Low risk	183,208	—	—	183,208
Moderate risk	835,257	—	—	835,257
High risk	—	91,671	20,957	112,628
	1,018,465	91,671	20,957	1,131,093
Personal				
Low risk	67,791	—	—	67,791
Moderate risk	11,482	263	—	11,745
High risk	68	489	6	563
	79,341	752	6	80,099
	4,647,042	156,008	25,905	4,828,955

The following table sets out the Credit Union's credit risk exposure for all Members' loans carried at amortized cost as at December 31, 2020. 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				
Low risk	1,565,852	—	—	1,565,852
Moderate risk	1,439,561	18,214	2,479	1,460,254
High risk	54,844	23,623	628	79,095
	3,060,257	41,837	3,107	3,105,201
Commercial				
Low risk	117,377	—	—	117,377
Moderate risk	775,018	190	—	775,208
High risk	—	52,724	37,323	90,047
	892,395	52,914	37,323	982,632
Personal				
Low risk	14,248	—	—	14,248
Moderate risk	12,005	185	1	12,191
High risk	185	178	5	368
	26,438	363	6	26,807
	3,979,090	95,114	40,436	4,114,640

As at December 31, 2021, 90% of outstanding commercial loans are risk rated 6 or less (2020 – 91%) based on the Credit Union's risk rating model.

Total loans in arrears greater than 30 days decreased to $40.2 million (83 basis points of total Members' loans) at the end of 2020 compared with $50.1 million at December 31, 2020 (122 basis points of total Members' loans).

The outbreak of COVID-19 has resulted in significant changes to the forward-looking macroeconomic inputs and the probability weights assigned to the forward-looking scenarios in the measurement of ECL. The scenarios incorporate assumptions about COVID-19 based on epidemiological, economic, and policy impacts during the pandemic, based on facts available at December 31, 2021.

Note 9 to the financial statements has additional disclosures with respect to ECL and its movements, gross loans by security type, key macroeconomic inputs used in scenarios, and delinquency aging analysis.

Non-Interest Expense

($ millions)	2021			2020		
	Expense	Mix	% of average assets	Expense	Mix	% of average assets
Salaries and benefits	37.4	55.8%	0.7%	32.2	53.3%	0.7%
Occupancy	3.0	4.5%	0.1%	2.9	4.8%	0.1%
Technology	5.6	8.3%	0.1%	5.9	9.7%	0.1%
Other general and administrative expenses	21.0	31.4%	0.4%	19.5	32.2%	0.4%
Total	67.0	100.0%	1.3%	60.5	100.0%	1.3%

Total non-interest expenses in 2021 were $67.0 million, up $6.5 million, or 10.8%, from the prior year.

The Efficiency Ratio was 67.9% compared with 76.5% for the years ended December 31, 2021 and 2020, respectively, driven by higher revenue in 2021.

Salaries and benefits were $37.4 million, up $5.2 million or 16.0% from the prior year driven primarily by higher number of full-time equivalent employees required to support growth.

Occupancy costs, which included rent expense, were $3.0 million, up $0.1 million, or 2.9%, from the prior year.

Technology costs decreased to $5.6 million, down $0.3 million, or 5.1%, from the prior year primarily related to one-time technology spend to support employee remote working arrangements in 2020.

Other general and administrative expenses increased by $1.6 million, or 8.2%, from the prior year due to higher amortization expenses and volume-related expenses partially offset by lower marketing spend.

Financial Condition Review

Total assets were $5.52 billion at December 31, 2021 compared with $5.11 billion at the end of 2020 and up 8.0% year-over-year due to an increase in loan balances.

DUCA's Member loan growth during 2021 was $714.3 million, resulting in an increase in loan balances of 17.4% from 2020's loan balances of $4.11 billion.

Residential mortgage balances increased by $512.6 million, or 16.5% (2019 – $512.0 million, or 19.7%). DUCA's partnership and proprietary channels, which include Branches, Mobile Mortgage Specialists and Member Connect call centre, accounted for substantially all of the increase.

DUCA's commercial loan balances increased by $148.5 million, or 15.1%, with all growth being supported by strong real estate assets within DUCA's geographic footprint.

Cash and cash equivalents, and investments and third-party mortgages totaled $602.4 million at December 31, 2021, down from $918.3 million in 2020. This decrease was primarily due to lower levels of cash and cash equivalents held as at December 31, 2021 and reflected the return to more normalized and lower liquidity levels as the Credit Union emerged out of peak Pandemic conditions.

Member deposits increased to $4.53 billion at December 31, 2021, up $718.8 million, or 18.9%, from 2020 to fund asset growth.

DUCA continued its program of securitizing residential mortgages through Canada Mortgage and Housing Corporation ("CMHC") 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 liabilities decreased to $463.2 million, down $234.9 million, or 33.6%, from the prior year as a result of lower levels of insurable mortgages originated by the Credit Union eligible for securitization pooling.

A comprehensive credit facility is maintained with Bank of Montreal up to a maximum of $14.0 million (2020 – $14.0 million) and is secured by bank deposit notes totaling $10.0 million (2020 – $10.0 million). The Credit Union has an unused credit facility of $14.0 million (2020 – $14.0 million) at year-end.

A line of credit is maintained with Central 1 up to a maximum of $235.0 million (2020 – $235.0 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 $134.2 million (2020 – $235.0 million) as at year-end, of which $100.0 million (2020 – $100.0 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 $30.0 million (2020 – $30.0 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 $25.0 million (2020 – $25.0 million) credit facility, which is secured by a pool of $31.1 million (2020 – $46.2 million) uninsured mortgages. Central 1 provides a Performance Guarantee on the drawn amount of the credit facility funded volume. As at December 31, 2021, the Credit Union has an unused credit facility of $20.0 million (2020 – $20.0 million).

A line of credit facility is maintained with Desjardins up to a maximum of $175.0 million (2020 – $175.0 million) and is secured by a pledge of residential mortgages. The Credit Union has an unused credit facility of $175.0 million (2020 – $175.0 million) as at year-end.

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 $350.0 million (2020 – $150.0 million) credit facility where the Credit Union can access borrowing on a short-term basis by pledging mortgage-backed securities that it is holding for liquidity. As at December 31, 2021, the Credit Union has an unused credit facility of $350.0 million (2020 – $52.2 million).

On May 29, 2020, the Credit Union entered into The Bond Market Association/International Securities Market Association 2000 Version Global Master Repurchase Agreement with Bank of Montreal, which gives the Credit Union access to an uncommitted $400.0 million (2020 – $400.0 million) credit facility where the Credit Union can access borrowing on a short-term basis by pledging mortgage-backed securities that it is holding for liquidity. As at December 31, 2021, the Credit Union has an unused credit facility of $400.0 million (2020 – $305.8 million).

On July 28, 2020, the Credit Union entered into The Bond Market Association/International Securities Market Association 2000 Version Global Master Repurchase Agreement with Central 1, which gives the Credit Union access to an uncommitted credit facility where the Credit Union can access borrowing on a short-term basis by pledging mortgage-backed securities that it is holding for liquidity.

Regulatory capital was $373.5 million at December 31, 2021 up from $360.4 million at December 31, 2020 driven by higher retained earnings.

DUCA's leverage ratio was 6.8% at the end of 2021 compared with 7.1% at the end of 2020 and exceeds the minimum of 4.0% stipulated in the *Credit Unions and Caisses Populaires Act, 1994* (the "Act").

DUCA's regulatory risk-weighted capital ratio was 14.2%, down 320 basis points from 17.4% at the end of 2020, 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 composed of Tier 1 capital. As at December 31, 2021, DUCA's Tier 1 capital represented 88.7% (2020 – 88.0%) of the overall capital base, well in excess of the minimum requirement.

Wealth assets under management was $505.0 million at December 31, 2021 up from $371.4 million at December 31, 2020. Wealth assets include mutual funds, stocks and bonds offered through an arrangement with Aviso Wealth as at December 31, 2021.

Subsequent to year-end on March 29, 2022, the Credit Union issued $75.0 million of subordinated indebtedness to a private investor and has included the issue as Tier 2 regulatory capital.

Subsequent to year-end on March 31, 2022, the Credit Union completed the acquisition of 100% of outstanding common shares of Continental Currency Exchange, Ltd., one of Canada's largest foreign exchange bureaus for proceeds of approximately $15.0 million.

Dividends

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

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

($ millions)	**2021**	**2020**	**2019**	**2018**	**2017**
Profit-sharing patronage return	1.5	2.2	1.4	1.2	1.2
Class A profit-sharing shares dividend	0.7	0.7	0.8	0.8	-
Class B series 1 shares dividend	1.2	1.4	1.2	1.2	1.3
Class B series 4 shares dividend	7.3	-	-	-	-

On February 26, 2021, the Board of Directors declared a dividend of 3.0% on the outstanding amount of the Class B Series 1 investment shares, a dividend of 4.25% on the outstanding amount of the Class B Series 4 investment shares, and a dividend of 2.0% on the outstanding amount of profit-sharing Class A shares to the holders of record as at December 31, 2020. The dividends were paid on March 2, 2021.

During 2021, the Board of Directors declared a profit-sharing patronage return of 1.0% (2020 – 1.0%) consisting of bonus interest on Members' deposits and loans, which was subsequently paid in March 2022.

Subsequent to year-end, on March 1, 2022, the Board of Directors declared a dividend of 3.0% on the outstanding amount of the Class B Series 1 investment shares, a dividend of 4.25% on the outstanding amount of the Class B Series 4 investment shares, and a dividend of 2.0% on the outstanding amount of profit-sharing Class A shares to the holders of record as at December 31, 2021. The dividends were subsequently paid in March 2022.

Capital Management

DUCA actively manages capital to maintain robust capital ratios and provide returns to our members, through an optimal capital structure and disciplined balance sheet management that provides flexibility for organic growth and strategic acquisitions. At all times, DUCA adheres to capital regulatory requirements prescribed by FSRA.

DUCA's capital management framework sets the overall governance approach, including guiding principles, roles and responsibilities, and establishes policies and processes for RWA and leverage ratio exposures. 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. The Board regularly reviews DUCA's capital position and key capital management activities.

Capital Requirements

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 5.0% (2020 – 5.0%) of the book value of all assets and 10.5% (2020 – 10.5%) of risk-weighted assets.

At December 31, 2021, DUCA's leverage ratio was 6.8% (2020 – 7.1%), the risk-weighted capital ratio was 14.2% (2020 – 17.4%) and the Tier 1 ratio to total capital was 88.7% (2020 – 88.0%). Both leverage and risk weighted capital ratios were higher in the prior year due to the issuance of Class B Series 4 shares in 2020.

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 DUCA's Enterprise Risk Management Policy are Risk Appetite Statements ("RAS") and the 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 Enterprise Risk Management Policy, ERMF, and related policies reflect 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 is 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 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 uses 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 centred 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, including Compliance and anti-money laundering and anti-terrorist financing functions. The Management Risk and Asset Liability Committee ("MRALCO") oversees enterprise-wide risk taking and risk mitigation activities.

- 3rd Line of Defense - The third line of defense consists of internal and external audit functions, 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 risks as outlined below:

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 and adjudication authority structure for the approval, amendment, and renewal of credit facilities;
- Delegating authorization limits to the Board Credit Committee, 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 Members and counterparties;
- Compliance with agreed exposure limits. Monthly reports are provided to the MCC and to the Board on the quality of the loan portfolio.

The CRMP applies to all loan products and includes personal, residential mortgage, small business, wealth management, and commercial lending.

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 and systems failures, fraud, theft and misappropriation of assets, business disruption, information, privacy, and 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 and regulatory compliance requirements, business continuity/disaster recovery, privacy and confidentiality, vendor management, counterparty risk 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.

The COVID-19 outbreak has led to disruptions of the Credit Union's business activity and a continued outbreak or infection rate increase may have a negative impact on the Credit Union and its financial performance. The Credit Union has mitigated disruptions by following its Business Resiliency Plan and procedures in response to the pandemic. The safety of Employees is a priority for the Credit Union, and it has leveraged its investment in information technology to enable the majority of its Employees to work remotely, with minimal disruptions to its operations. Employee workplace safety protocols have also been implemented to ensure that essential Employees working on site have a safe working environment.

Capital, Liquidity and Market Risk

1. Capital Risk

   The Internal Capital Adequacy Assessment Process ("ICAAP") is an integrated enterprise-wide process for evaluating and determining the amount of capital required to manage through unexpected losses arising from adverse economic and operational conditions. The methodology used to calculate the internal capital requirements incorporates all the material risks faced by DUCA and is reflective of the actual risk profile.

   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. During 2021, the application of the ICAAP confirmed that DUCA's capital levels were sufficient. The Credit Union expects continued asset growth in the future and will proactively manage its capital to ensure capital sufficiency on an ongoing basis.

   On March 1, 2022, the Credit Unions and Caisses Populaires Act, 2020 ("CUCPA 2020" or "New Act") came into force, replacing the Credit Unions and Caisses Populaires Act, 1994 ("CUCPA 1994"). Along with the New Act, three new Credit Union Rules developed by FSRA, Sound Business and Financial Practices Rule, Capital Adequacy Requirements Rule, and Liquidity Adequacy Requirements Rules also came into force on March 1, 2022.

   The Capital Adequacy Requirements Rule in particular outlined significant changes to capital requirements including i) definition and calculation of capital and risk weighted assets, ii) revision in supervisory minimum ratios, iii) introduction of a capital conservation buffer and iv) capital reporting of subsidiaries on a consolidated basis, among other changes. DUCA is finalizing the assessment of the impact of these changes on our compliance and reporting processes and expects to be compliant with the new Rules.

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 refers to the risk of having insufficient cash or collateral to meet financial obligations in a timely manner, and an inefficacy to raise funding or monetize assets at non-distressed prices. Liquidity risk arises from mismatches in the timing and value of on-balance sheet and off-balance sheet cash flows, and depends on diversity in funding sources, the business mix, balance sheet structure, and contingent liquidity events that require additional funding for undrawn loan commitments or deposit attrition.

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.
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 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 as at December 31, 2021 was 618% (2020 – 502%) compared with a regulatory minimum of 100% and a policy minimum of 125%.

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 as at December 31, 2021 was 116% (2020 – 152%) 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 as at December 31, 2021 was 171% (2020 – 182%) compared with a regulatory minimum of 100% and a policy minimum of 110%.

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 as at December 31, 2021 was 13.5% (2020 – 20.5%) compared with a policy minimum of 10.0%.

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 Member originated deposits and loans, mismatch between asset and liability repricing dates and prepayment and callable optionality.

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 and filed with FSRA by Credit Union regulations. For the years ended December 31, 2021 and December 31, 2020, 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 Members, as well as currency purchase costs. The Credit Union's exposure to changes in currency exchange rates is mitigated by limiting the unhedged foreign currency exposure to the lesser of $1.0 million or 5.0% of total Member foreign currency deposits in Canadian funds. For the year ended December 31, 2021, 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, which may be subject to higher volatility as a result of the pandemic and its disruption on global equity markets.

For the year ended December 31, 2021, 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 Executive Leadership Team ("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 the risk of legal or regulatory sanctions, material financial loss, or loss to reputation a credit union may suffer as a result of its failure to comply with laws, regulations, codes of conduct, and standards of practice applicable to its banking activities.

Some of the examples of common compliance risks include crime, corruption, fraud, money laundering, terrorist financing, data protection, privacy breaches, and conflicts of interest.

An effective compliance risk management program is essential for a sound banking system and includes Board oversight of a compliance risk management process. Additionally, senior management sets the organizational tone and priority with the implementation of a compliance culture on an enterprise-wide basis, as well as ensuring the independence of this function. It is the responsibility of all DUCA Employees to protect its reputation and ensure compliance with all applicable laws, regulations, and standards.