

**2018 CONSOLIDATED
FINANCIAL STATEMENTS OF
FIRSTONTARIO CREDIT UNION LIMITED**

CONTENTS

Report on Management Responsibility	1
Report of the Audit and Risk Committee	2
Consolidated Financial Statements:	
Independent Auditors' Report	3
Consolidated Statement of Financial Position	6
Consolidated Statement of Income	7
Consolidated Statement of Income and Other Comprehensive Income	8
Consolidated Statement of Changes in Members' Equity	9
Consolidated Statement of Cash Flows	10
Notes to Consolidated Financial Statements	11

REPORT ON MANAGEMENT RESPONSIBILITY

The accompanying Consolidated Financial Statements and all information contained in this Annual Report are the responsibility of the Management of FirstOntario Credit Union Limited, which is responsible for the integrity and fairness of the information presented. The Consolidated Financial Statements, in the opinion of Management, have been prepared using appropriate accounting policies that are in accordance with International Financial Reporting Standards and the Credit Unions and Caisses Populaires Act, 1994 (Ontario) and are based on informed judgments and estimates of the expected effects of current events and transactions.

To meet its responsibility for the integrity and objectivity of data in the Consolidated Financial Statements, Management has developed and maintains a system of internal accounting controls. Management believes that this system of internal controls provides reasonable assurance that the financial records are reliable and form a proper basis for preparation of Consolidated Financial Statements and that assets are properly accounted for and are safeguarded.

The Board of Directors is responsible for reviewing and approving the Consolidated Financial Statements and for overseeing Management's performance of its financial reporting responsibilities. The Board of Directors carried out its responsibility for the Consolidated Financial Statements through its regular review of financial results and operations and through its Audit Committee. The Member-appointed auditors have full and free access to, and meet periodically with, the Audit and Risk Committee and may meet with the Board of Directors, with or without Management present, to discuss their audit and matters relating to financial statement presentation, internal controls and audit procedures.

The Deposit Insurance Corporation of Ontario conducts periodic examination of the financial conditions and affairs of FirstOntario. The examination includes review of FirstOntario's compliance with the provisions of the Act.

KPMG LLP, Member-appointed external auditors, has examined the Consolidated Financial Statements in accordance with Canadian generally accepted auditing standards and their independent auditors' report is shown as part of the Consolidated Financial Statements.

Lloyd Smith, CPA, CGA, CCE
Interim Chief Executive Officer

Barry Doan, CPA, CA, MAcc
Chief Financial Officer

March 6, 2019

REPORT OF THE AUDIT AND RISK COMMITTEE

FirstOntario Credit Union Limited's Audit and Risk Committee is a committee of the Board of Directors pursuant to Section 125 of the Credit Unions and Caisses Populaires Act, 1994 (Ontario) and Section 27 of Ontario Regulation 237/09. The Committee, which consists of six directors, has a mandate to cover all of the duties, which are specified to be performed by audit committees in the Regulations of the Act.

The Audit and Risk Committee is pleased to report to the Members of FirstOntario that it has fulfilled its annual mandate. During the year the Committee held 11 meetings and completed the following significant activities:

- (a) Served as the principal communication link between the external auditors and the Board of Directors and, in particular, reviewed the terms of engagement and scope of the audit and reviewed FirstOntario's annual financial statements prior to Board approval for issuance to the Members.
- (b) Obtained a reasonable understanding of the important elements of internal controls that are important to safeguarding the assets of FirstOntario, ensuring the accuracy of financial reports and ensuring compliance with policies and procedures.
- (c) Served as the Board's liaison with the internal auditor and reviewed the internal audit mandate, work plan and reports.
- (d) Reviewed the policies, procedures and controls, which relate to legislative compliance, with a particular focus on requirements for liquidity, capital adequacy and interest rate management.
- (e) Reviewed management's identification of the significant risks of FirstOntario in accordance with the Enterprise Risk Management policy and ensured processes were in place to measure, monitor, manage and mitigate significant risk exposures including appropriate policies, procedures and controls.

There are no significant recommendations made by the Audit and Risk Committee that have not been either implemented or are in the process of being implemented. In addition, there are no matters which the Audit and Risk Committee believes should be reported to the Members, other than as described above, nor are there any further matters that are required to be disclosed pursuant to the Act or the Regulations thereto.

Based on its findings, the Audit and Risk Committee issues reports and makes recommendations to the Board of Directors or senior management, as appropriate, with respect to the matters outlined above and follows up to ensure that the recommendations are considered and implemented. During the year, the Committee received full co-operation and support from management to enable it to play an effective role in maintaining the quality of financial reporting to the Members and enhancing the overall control structure of FirstOntario.

Stu Walker
Chair, Audit and Risk Committee

March 6, 2019



KPMG LLP
Commerce Place
21 King Street West, Suite 700
Hamilton Ontario L8P 4W7
Canada
Telephone (905) 523-8200
Fax (905) 523-2222

INDEPENDENT AUDITORS' REPORT

To the Members of FirstOntario Credit Union Limited

Opinion

We have audited the accompanying consolidated financial statements of FirstOntario Credit Union Limited (the "Credit Union"), which comprise:

- the consolidated statement of financial position as at end of December 31, 2018
- the consolidated statement of income for the year then ended
- the consolidated statement of income and other comprehensive income for the year then ended
- the consolidated statement of changes in members' equity for the year then ended
- the consolidated statement of cash flows for the year then ended
- and notes to the consolidated financial statements, including a summary of significant accounting policies

(Hereinafter referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the consolidated financial position of the Credit Union as at end of December 31, 2018 and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the "*Auditors' Responsibilities for the Audit of the Financial Statements*" section of our auditors' report.

We are independent of the Credit Union in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada and we have fulfilled our other responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.



Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Credit Union's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Credit Union or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Credit Union's financial reporting process.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.

The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Credit Union's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.



- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Credit Union's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Credit Union to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represents the underlying transactions and events in a manner that achieves fair presentation.
- Communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

A handwritten signature in black ink that reads 'KPMG LLP'. The signature is written in a cursive, slightly slanted style. Below the signature is a horizontal line that starts under the 'K' and ends under the 'P'.

Chartered Professional Accountants, Licensed Public Accountants

Hamilton, Canada

March 6, 2019

FIRSTONTARIO CREDIT UNION LIMITED

Consolidated Statement of Financial Position

As at December 31, 2018, with comparative information for 2017

(In thousands of dollars)	2018	2017
Assets		
Loans Receivable from Members		
Residential mortgage loans (note 5)	\$ 2,722,818	\$ 2,437,411
Personal loans (note 5)	118,869	128,287
Commercial loans (note 5)	747,565	808,779
Accrued interest receivable	19,754	18,918
	3,609,006	3,393,395
Other		
Cash and cash equivalents (note 7)	62,317	43,098
Investments (note 9)	495,853	408,296
Fixed assets (note 10)	39,109	38,201
Derivative financial instruments (note 15)	443	1,383
Other assets	6,109	5,899
	\$ 4,212,837	\$ 3,890,272
Liabilities		
Members' Deposits and Shares		
Deposits (note 11)	\$ 3,289,238	\$ 2,784,346
Membership shares (note 12)	9,213	8,591
Investment shares (note 12)	12,425	12,668
Accrued interest on deposits and shares	21,528	14,791
	3,332,404	2,820,396
Other		
Loans payable and securitization liabilities (note 14)	608,088	802,382
Accounts payable and accrued liabilities	45,573	49,660
Derivative financial instruments (note 15)	1,195	1,329
	3,987,260	3,673,767
Members' Equity		
Investment shares (note 12)	106,934	104,208
Contributed surplus	4,865	4,865
Retained earnings	116,784	111,323
Accumulated other comprehensive loss	(3,006)	(3,891)
	225,577	216,505
	\$ 4,212,837	\$ 3,890,272

See accompanying notes to Consolidated Financial Statements.

On behalf of the Board:

Carey Smith
Director

Stu Walker
Director

FIRSTONTARIO CREDIT UNION LIMITED

Consolidated Statement of Income

For the year ended December 31, 2018, with comparative information for 2017

(In thousands of dollars)	2018	2017
Interest Income		
Members' loans (note 5)	\$ 129,774	\$ 116,536
Other	3,176	8,215
	132,950	124,751
Interest Expense		
Members' deposits (note 11)	50,938	37,205
Dividends on membership and investment shares (note 12)	1,150	996
Loans payable and securitization liabilities (note 14)	15,851	19,117
Other	97	667
	68,036	57,985
Net Interest Income		
Provision for impaired loans (note 6)	(2,445)	(1,642)
Other income (note 19)	31,418	26,567
Net Interest and Other Income	93,887	91,691
Non-interest Expenses		
Salaries and employee benefits	46,504	41,096
Administrative	17,856	15,847
Technology	11,084	9,533
Occupancy	7,485	7,190
Donations and community sponsorship	1,550	1,380
	84,479	75,046
Income before Income Taxes		
	9,408	16,645
Income taxes (note 20)	1,339	3,434
Net Income for the year	\$ 8,069	\$ 13,211

See accompanying notes to Consolidated Financial Statements.

FIRSTONTARIO CREDIT UNION LIMITED
Consolidated Statement of Income and Other Comprehensive Income

For the year ended December 31, 2018, with comparative information for 2017

(In thousands of dollars)	2018	2017
Net income for the year	\$ 8,069	\$ 13,211
Other Comprehensive Income (Loss)		
Items that are or may be reclassified subsequently to net income:		
Net loss on cash flow hedges	(1,276)	-
Net gain on cash flow hedges transferred to earnings	855	1,489
Net change in fair value of available for sale investments	-	(17)
Related income taxes (note 20)	78	(303)
Items that are not recycled or reclassified to net income:		
Actuarial gain (loss) on employee benefits, net of tax	1,228	(1,127)
Total Income and Other Comprehensive Income for the year	\$ 8,954	\$ 13,253

See accompanying notes to Consolidated Financial Statements.

FIRSTONTARIO CREDIT UNION LIMITED

Consolidated Statement of Changes in Members' Equity

For the year ended December 31, 2018, with comparative information for 2017

(In thousands of dollars)	Investment shares	Contributed surplus	Retained earnings	Accumulated Other Comprehensive Income (Loss)			Total
				Cash flow hedging reserve	Financial instruments at FVOCI ^(a)	Employee benefits	
Balance, January 1, 2018	\$ 104,208	\$ 4,865	\$ 111,323	\$ (1,036)	\$ -	\$ (2,855)	\$ 216,505
Change on initial application of IFRS 9 (note 22)	-	-	744	-	-	-	744
Restated balance as at January 1, 2018	104,208	4,865	112,067	(1,036)	-	(2,855)	217,249
Shares issued during the year	4,217	-	-	-	-	-	4,217
Shares redeemed during the year	(1,491)	-	-	-	-	-	(1,491)
Net income for the year	-	-	8,069	-	-	-	8,069
Dividends paid (net of tax recovery \$865)	-	-	(3,352)	-	-	-	(3,352)
Other comprehensive income (loss)	-	-	-	(343)	-	1,228	885
Balance, December 31, 2018	\$ 106,934	\$ 4,865	\$ 116,784	\$ (1,379)	\$ -	\$ (1,627)	\$ 225,577

(a) Current period balance is classified at FVOCI for debt and equity instruments, however, balance at beginning of the period is classified as available-for-sale under IAS 39.

(In thousands of dollars)	Investment shares	Contributed surplus	Retained earnings	Accumulated Other Comprehensive Income (Loss)			Total
				Cash flow hedging reserve	Fair value reserve for AFS investments	Employee benefits	
Balance, January 1, 2017	\$ 103,246	\$ 4,865	\$ 99,232	\$ (2,217)	\$ 12	\$ (1,728)	\$ 203,410
Shares issued during the year	1,404	-	-	-	-	-	1,404
Shares redeemed during the year	(442)	-	-	-	-	-	(442)
Net income for the year	-	-	13,211	-	-	-	13,211
Dividends paid (net of tax recovery \$284)	-	-	(1,120)	-	-	-	(1,120)
Other comprehensive income (loss)	-	-	-	1,181	(12)	(1,127)	42
Balance, December 31, 2017	\$ 104,208	\$ 4,865	\$ 111,323	\$ (1,036)	\$ -	\$ (2,855)	\$ 216,505

See accompanying notes to Consolidated Financial Statements.

FIRSTONTARIO CREDIT UNION LIMITED

Consolidated Statement of Cash Flows

For the year ended December 31, 2018, with comparative information for 2017

(In thousands of dollars)	2018	2017
Cash Flows from Operating Activities		
Net income for the year	\$ 8,069	\$ 13,211
Adjustments for:		
Amortization of fixed assets	5,277	4,998
Net change in fair value of assets recorded as fair value through profit or loss	(9,673)	(4,554)
Gain on sale of assets	36	-
Net changes in accrued employee retirement benefits	(1,204)	1,423
Other non-cash items, net	(14,204)	(10,052)
Net interest income	(64,914)	(66,766)
Income tax expense	1,339	3,434
Changes in operating assets:		
Net change in loans receivable from Members	(213,734)	(12,460)
Net change in derivative assets held for risk management	794	256
Changes in operating liabilities:		
Net change in deposits	504,892	446,271
Net change in derivative liabilities held for risk management	957	(789)
Interest received	135,210	125,059
Interest paid	(60,052)	(53,732)
Income tax paid	(1,276)	(1,314)
Cash flows from operating activities	291,517	444,985
Cash Flows from Financing Activities		
Net issuance (redemptions) in membership shares	(28)	30
Net redemptions in investment shares	(2,234)	(1,139)
Net change in loans payable and securitization liabilities	(193,671)	(396,414)
Cash flows used in financing activities	(195,933)	(397,523)
Cash Flows from Investing Activities		
Net investment purchases	(70,144)	(39,906)
Purchase of fixed assets, net of disposals	(6,221)	(7,484)
Cash flows used in investing activities	(76,365)	(47,390)
Cash and cash equivalents		
Net increase during year	19,219	72
Balance at beginning of year	43,098	43,026
Balance at end of year	\$ 62,317	\$ 43,098

See accompanying notes to Consolidated Financial Statements.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

1. Corporate Information:

FirstOntario Credit Union Limited ("FirstOntario") is a financial institution incorporated in Ontario which operates in compliance with the Credit Unions and Caisses Populaires Act of Ontario (the "Act") and is a member of Central 1 Credit Union ("Central 1"). The location of the head office and principal place of business of FirstOntario is 970 South Service Road, Stoney Creek, Ontario, L8E 6A2.

FirstOntario exists to help Members meet their financial needs in their local communities. FirstOntario's principal activities are the provision of deposit-taking, lending and other financial services.

FirstOntario's Member deposits are insured by the Deposit Insurance Corporation of Ontario ("DICO") under a mandatory program, the expense for which amounted to \$2,040,000 (2017 - \$1,565,000). At December 31, 2018, there were 126,542 Members (2017 - 118,738).

2. Basis of Preparation:

Statement of compliance

The Consolidated Financial Statements of FirstOntario have been prepared in accordance with International Financial Reporting Standards ("IFRS"). IFRS comprise of accounting standards issued by the International Accounting Standards Board ("IASB") as well as interpretations issued by the IFRS Interpretations Committee.

These financial statements were approved by FirstOntario's Board of Directors on March 6, 2019. The significant accounting policies used in the preparation of these Consolidated Financial Statements are summarized below and have been applied consistently to all periods presented in the financial statements.

Details of FirstOntario's accounting policies, including changes during the year, are included in Notes 3 and 22. As explained in Note 22, FirstOntario has adopted IFRS 9 *Financial Instruments* issued in July 2014 with a date of initial application of January 1, 2018, and IFRS 15 *Revenue from Contracts with Customers* issued in May 2017 with a date of initial application of January 1, 2018.

Use of estimates and judgments

The preparation of Consolidated Financial Statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts in revenue and expenses during the reporting year. Actual future results could differ from those estimates.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

2. Basis of Preparation (continued):

Use of estimates and judgments (continued)

Items which result in the most significant areas of application of judgment and estimates include the following:

(a) Fair value of financial instruments:

Where fair value of financial assets and liabilities cannot be derived from active markets, FirstOntario uses valuation techniques that include inputs derived from either observable market data or utilizing management judgment. Refer to Note 17 for information relating to these estimates.

(b) Allowance for impairment on loans:

Policy applicable from January 1, 2018

FirstOntario assesses whether credit risk has increased significantly since loan origination, estimates probability of default and loss given default, and incorporates forward-looking information in the measurement of expected credit loss on its loan portfolio.

Policy applicable before January 1, 2018

FirstOntario reviewed its loan portfolio frequently to assess impairment, and used considerable judgment in determining whether or not a loan was impaired as a result of observable evidence. If a loan was considered to be impaired, the amount of the loss was estimated based on management's best estimates.

Refer to Note 6 for information relating to these estimates.

(c) Employee retirement benefits:

FirstOntario estimates the present value of employee retirement benefits, which depends on a number of assumptions including discount rates, expected salary and other cost increases, and mortality rates. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating the terms of the related pension liability. Refer to Note 18 for information relating to these estimates.

(d) Hedging and securitizations:

FirstOntario enters into securitization and hedging transactions which require management's best estimates of key assumptions that market participants would use in determining fair value. For more information relating to these estimates refer to Note 8 for securitizations and Note 16 for hedges.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

3. Significant Accounting Policies:

These consolidated financial statements have been prepared on a going concern basis. The significant accounting policies applied in the preparation of these consolidated financial statements are set out below. The policies have been consistently applied to all of the periods presented.

(a) Basis of consolidation:

The Consolidated Financial Statements include the assets, liabilities and results of the operations of FirstOntario, 1320818 Ontario Limited, FirstOntario Insurance Holdings Inc. ("FOIH") and FirstOntario Insurance Brokerage Inc. ("FOIB").

1320818 Ontario Limited is a wholly owned subsidiary of FirstOntario. 1320818 Ontario Limited supplies information technology services and operates the banking system for FirstOntario. All intercompany transactions and balances have been eliminated.

FOIH is a wholly owned subsidiary of FirstOntario. FOIH is a holding company which manages FirstOntario's holdings in FOIB. FOIH holds 51% of the ownership interests and voting rights of FOIB. All intercompany transactions and balances have been eliminated.

Investments in which FirstOntario exercises joint control are accounted for as a joint venture, whereby FirstOntario's share of revenue and expenses of the joint ventures are included in the Consolidated Statement of Income. FirstOntario's net share of the assets (liabilities) of the investments are included in the Consolidated Statement of Financial Position. Investments are considered to be jointly controlled if there is a contractual agreement to share authority over determining the investments' operating, investment and financing policies. The joint ventures in which FirstOntario participates include real estate development for the purpose of resale as well as retail and commercial complexes that generate rental and leasing income.

(b) Financial instruments – recognition and measurement:

FirstOntario initially recognizes loans, deposits and mortgage securitization liabilities on the date on which they are originated. All other financial instruments are recognized on the trade date, which is the date on which FirstOntario becomes a party to the contractual provisions of the instrument.

All financial assets and liabilities are initially measured at fair value, plus transaction costs that are directly attributable to its acquisition or issue, for an item not at fair value through profit and loss ("FVTPL"). Subsequent measurement is dependent upon the financial instrument's classification.

Financial assets and liabilities comprise cash and cash equivalents, derivatives, investments, loans receivable from Members, Members' deposits and shares, loans payable, securitization liabilities and accounts payable and accrued liabilities.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

3. Significant Accounting Policies (continued):

(b) Financial instruments – recognition and measurement (continued):

Classification and measurement of financial instruments

Policy applicable from January 1, 2018

On initial recognition, a financial asset is classified as measured at amortized cost, fair value through other comprehensive income (“FVOCI”) or fair value through profit and loss (“FVTPL”).

The amortized cost of a financial instrument is the amount at which the instrument is measured on initial recognition minus the principal repayments, plus or minus the cumulative amortization using the effective interest rate method, and for financial assets, adjusted for any expected credit loss allowance.

A financial asset is measured at amortized cost if it meets both of the following conditions and is not designated as FVTPL:

- the asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Subsequent to initial recognition, FVOCI financial assets are measured at fair value whereby the unrealized gains and losses are recorded in other comprehensive income (“OCI”) and included in accumulated other comprehensive income (“AOCI”). Upon derecognition, the cumulative gains or losses of debt instruments are reclassified from OCI and recorded in the Consolidated Statement of Income.

A debt instrument is measured at FVOCI only if it meets both of the following conditions and is not designated as FVTPL:

- the asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

On initial recognition of an equity investment that is not held for trading, FirstOntario may irrevocably elect to present subsequent changes in FVOCI. This election is made on an investment by investment basis. Upon derecognition, any cumulative gains or losses in OCI on equity investments so designated is not recognized in profit or loss.

All other financial assets are classified as measured at FVTPL. Financial instruments measured at FVTPL are subsequently measured at fair value at each reporting date. Gains and losses realized on disposal together with dividends and interest earned on these instruments are reported in interest and other income. Unrealized gains and losses from changes in fair value are reported separately in other income in the Consolidated Statement of Income.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

3. Significant Accounting Policies (continued):

(b) Financial instruments – recognition and measurement (continued):

On initial recognition, FirstOntario may irrevocably designate a financial instrument that otherwise meets the requirements to be measured at amortized cost or at FVOCI as at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Business model assessment

Business model assessment involves determining whether financial assets are held and managed by FirstOntario for generating and collecting contractual cash flows, selling the financial assets or both. FirstOntario makes an assessment of the objective of a business model in which an asset is held at a portfolio level because this best reflects the way the business is managed and information is provided to management. The information considered includes:

- the stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether management's strategy focuses on earning contractual interest revenue or realizing cash flows through the sale of the assets;
- how the performance of the asset is evaluated and reported to FirstOntario's management;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and how these risks are managed;
- how managers of the business are compensated (for example, whether compensation is based on the fair value of the assets managed or the contractual cash flows collected);
- the frequency, volume and timing of sales in prior periods, the reasons for such sales and its expectations about future sales activity.

Financial assets that are held for trading and whose performance is evaluated on a fair value basis are measured at FVTPL because they are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets.

If upon origination of a financial asset, based on established criteria, the financial asset is expected to be securitized as part of a portfolio that qualifies for derecognition, the business objective of holding the financial asset to collect contractual cash flows is not met. Such financial assets are measured at FVTPL. If the financial asset is expected to be securitized as part of a portfolio that does not qualify for derecognition, the held to collect business model is considered to be met, and the financial asset is measured at amortized cost.

Assessment whether contractual cash flows are solely payments of principal and interest

The contractual cash flow characteristics assessment involves assessing the contractual features of an instrument to determine if they give rise to cash flows that are consistent with a basic lending arrangement, that is, if they represent cash flows that are solely payments of principal and interest ("SPPI").

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

3. Significant Accounting Policies (continued):

(b) Financial instruments – recognition and measurement (continued):

Principal is defined as the fair value of the financial asset on initial recognition. Interest is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding and other basic lending risks and costs (for example, liquidity risk and administrative costs), as well as profit margin.

In assessing whether the contractual cash flows are SPPI, FirstOntario considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition.

Reclassifications

Financial assets are not reclassified subsequent to their initial recognition, except in the period after FirstOntario changes its business model for managing financial assets. There were no changes to any of FirstOntario's business models during the current year.

Financial Liabilities

FirstOntario classifies its financial liabilities as measured at amortized cost or FVTPL.

FirstOntario has designated certain financial liabilities as FVTPL in either of the following circumstances:

- the liabilities are managed, evaluated and reported internally on a fair value basis; or
- the designation eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Classification of investment instruments is outlined in Note 9. Classification of all financial instruments is outlined in Note 17.

Policy applicable before January 1, 2018

Financial assets and liabilities designated as FVTPL were financial instruments either classified as held for trading ("HFT") or were managed and evaluated on a fair value basis in accordance with a documented risk management strategy. HFT financial assets and liabilities were acquired or incurred principally for resale, generally within a short period of time.

FVTPL financial assets and liabilities were subsequently measured at fair value at each reporting date. Gains and losses realized on disposal together with dividends and interest earned on these instruments were reported in interest and investment income. Unrealized gains and losses from changes in fair value were reported separately in the Consolidated Statement of Income.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

3. Significant Accounting Policies (continued):

(b) Financial instruments – recognition and measurement (continued):

Held-to-maturity (“HTM”) financial assets were non-derivative financial assets with fixed or determinable payments and fixed maturity, other than Loans and Receivables, that FirstOntario had the positive intention and ability to hold to maturity. These financial assets were subsequently measured at amortized cost using the effective interest method.

Available-for-sale (“AFS”) financial assets were those non-derivative financial assets that were not classified as FVTPL, HTM or Loans and Receivables. AFS instruments were subsequently measured at fair value whereby the unrealized gains and losses were recognized in other comprehensive income and included in accumulated other comprehensive income (“AOCI”), as discussed below, until sale or significant and prolonged impairment when the cumulative gain or loss was transferred to the Consolidated Statement of Income. AFS financial assets whose fair value is not reliably measurable were carried at cost. Realized gains and losses on sale were recorded in other income. Write downs to reflect impairment in value were recorded in unrealized gains (losses).

Loans and Receivables were non-derivative financial assets with fixed or determinable payments that were not quoted in an active market. Financial assets classified as Loans and Receivables were initially accounted for net of transaction costs and were subsequently measured at amortized cost by applying the effective interest method.

Financial liabilities classified as Other Liabilities were subsequently measured at amortized cost. Financial liabilities were initially recognized on the trade date FirstOntario became party to the contractual provision of the instrument. FirstOntario derecognized a financial liability when its contractual obligations were discharged, cancelled or expire.

Effective interest rate method

Interest income and expense are recognized in the Consolidated Statement of Income using the effective interest method. The calculation of the effective interest rate includes transaction costs, fees and discounts or premiums that are an integral part of the effective yield on the financial asset or liability.

Policy applicable from January 1, 2018

The effective interest rate is the rate that discounts the estimated future cash payments and receipts through the expected life of the financial instrument to the gross carrying amount of the financial asset or the amortized cost of the financial liability. When calculating the effective interest rate for financial instruments other than credit-impaired assets, FirstOntario estimates future cash flows considering all financial terms of the financial instrument, but not expected credit losses. For credit-impaired financial assets, a credit-adjusted effective interest rate is calculated using estimated future cash flows including expected credit losses.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

3. Significant Accounting Policies (continued):

(b) Financial instruments – recognition and measurement (continued):

Policy applicable before January 1, 2018

The effective interest rate was the rate that discounted the estimated future cash payments and receipts through the expected life of the financial asset or liability to its net carrying amount upon initial recognition. The effective interest rate was established on initial recognition of the financial asset or liability and was not revised subsequently.

Transaction costs

Transaction costs are incremental costs that are directly attributable to the acquisition, issuance or disposal of a financial asset or liability. Transaction costs related to FVTPL financial assets and liabilities are expensed as incurred. Transaction costs relating to amortized cost financial instruments (AFS and HTM financial assets and loans and receivables before January 1, 2018) are capitalized and amortized over the expected life of the instrument using the effective interest method.

Offsetting

Financial assets and liabilities are offset and the net amount presented in the Consolidated Statement of Financial Position when, and only when, FirstOntario has a legal right to set off the recognized amounts and it intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted under IFRSs, or for gains and losses arising from a group of similar transactions.

Identification and measurement of impairment losses

Policy applicable after January 1, 2018

FirstOntario recognizes loss allowances for expected credit loss (“ECL”) on financial instruments that are not measured at FVTPL. Loss allowances are measured at an amount equal to lifetime ECL, except for financial instruments on which credit risk has not increased significantly since their initial recognition, for which they are measured at 12-month ECL. 12-month ECL are the portion of ECL that result from default events on a financial instrument that are possible within the 12 months after the reporting date.

ECL is a probability-weighted estimate of credit losses, which considers multiple scenarios based on reasonable and supportable information about past events, current conditions and forecasts of future economic conditions. Forward-looking information is explicitly incorporated into the estimation of ECL.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

3. Significant Accounting Policies (continued):

(b) Financial instruments – recognition and measurement (continued):

Measurement of expected credit losses

The determination of whether the ECL is calculated on a 12 month or lifetime basis is dependent on the stage the financial asset falls into at the reporting date. A financial instrument moves across stages based on an increase or decrease in its risk of default at the reporting date compared to its risk of default at initial recognition. When determining whether the risk of default on a financial instrument has increased significantly since initial recognition, FirstOntario considers reasonable and supportable information that is relevant and available without undue cost or effort. There is a rebuttable presumption that the risk of default of the financial instrument has increased since initial recognition when contractual payments are more than 30 days overdue.

In assessing whether a financial asset is credit-impaired, FirstOntario considers qualitative and quantitative factors. Evidence that a financial asset is credit-impaired includes significant financial difficulty of the borrower or issuer, a breach of contract such as a default or past due event, and/or it becoming probable that the borrower or issuer will enter bankruptcy or other financial reorganization. In addition, a loan that is overdue for 90 days or more is considered impaired.

Restructured financial assets

If the terms of a financial asset are renegotiated or modified or an existing financial asset is replaced with a new one due to financial difficulties of the borrower, then an assessment is made of whether the financial asset should be derecognized and ECL is measured as follows:

- if the expected restructuring will not result in derecognition of the existing asset, then the expected cash flows arising from the modified financial asset are included in calculating the cash shortfalls from the existing asset
- if the expected restructuring will result in derecognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its derecognition. This amount is included in calculating the cash shortfalls from the existing financial asset that are discounted from the expected date of derecognition to the reporting date using the original effective interest rate of the existing financial asset.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

3. Significant Accounting Policies (continued):

(b) Financial instruments – recognition and measurement (continued):

Presentation of allowance for expected credit losses

Loss allowances for ECL are presented in the Consolidated Statement of Financial Position as follows:

- financial assets measured at amortized cost: as a deduction from the gross carrying amount of the assets;
- loan commitments and financial guarantee contracts: generally, as a provision;
- where a financial instrument includes both a drawn and undrawn component, and FirstOntario cannot identify the ECL on the loan commitment component separately from those on the drawn component: FirstOntario presents a combined loss allowance for both components. The combined amount is presented as a deduction from the gross carrying amount of the drawn component. Any excess of the loss allowance over the gross amount of the drawn component is presented as a provision; and
- debt instruments measured at FVOCI: no loss allowance is recognized in the Consolidated Statement of Financial Position because the carrying amount of these assets is their fair value. However, the loss allowance is disclosed and is recognized in the fair value reserve.

Write-offs

Impaired financial assets are written off (either partially or in full) when there is no realistic prospect of recovery. This is generally the case when FirstOntario determines the borrower cannot generate sufficient cash flows to repay the amounts subject to write-off. However, financial assets that are written off could still be subject to collection activities in compliance with FirstOntario's procedures. In subsequent periods, recoveries against written off loans are credited to the provision for impaired loans in the Consolidated Statement of Income.

Refer to Note 6 for further details.

Policy applicable before January 1, 2018

At each reporting date FirstOntario assessed whether there was objective evidence that financial assets not carried at fair value through profit or loss were impaired. A financial asset or group of financial assets was (were) impaired when objective evidence demonstrated that a loss event had occurred after the initial recognition of the asset(s), and that the loss event had an impact on the future cash flows of the asset(s) that could be estimated reliably.

For available-for-sale investments in equity securities, objective evidence included a significant or prolonged decline in its fair value below its cost.

For loans and receivables and held to maturity assets, impairment was assessed at the individual and collective levels. Objective evidence could include, but was not limited to, reasonable doubt as to the collectability of principal and interest, or when loan payments were 90 days past due.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

3. Significant Accounting Policies (continued):

(b) Financial instruments – recognition and measurement (continued):

Collective allowances were established on a portfolio basis to absorb probable loan losses for which a loss event had occurred but had not yet been identified by management. The collectively assessed allowance was based on portfolio quality, past experience, current economic conditions and management's judgment.

Derivative financial instruments

Derivative financial instruments are financial contracts whose value is derived from interest rates or other financial indices in the equity markets. In the ordinary course of business, FirstOntario enters into various derivative contracts, including interest rate swaps, equity-linked options, foreign exchange forwards and bond forwards. FirstOntario enters into such contracts to manage interest rate fluctuations and foreign exchange risk as part of FirstOntario's asset/liability management program.

Interest rate swaps involve the periodic exchange of payments without the exchange of the notional principal amount upon which the payments are based. Equity-linked options are purchased to hedge deposit products whose interest is linked to various equity indices or a specific bundle of equities. These contracts pay returns based on the change in value of equity indices or a specific bundle of equities.

Foreign exchange contracts are used to hedge FirstOntario's net US dollar liability position.

Derivatives are measured at fair value and are reported as assets where they have a positive fair value and as liabilities where they have a negative fair value. In both cases they are reported as derivative financial instruments in the financial statements.

Derivatives embedded in other financial instruments are separated from the host contract and accounted for separately if their economic characteristics and risks are not closely related to those of the host contract; the terms of the embedded derivatives would meet the definition of a derivative if it was a free standing instrument, the combined contract is not designated as FVTPL and recorded at fair value, and from January 1, 2018, the host contract is not an asset in the scope of IFRS 9. These embedded derivatives are classified as part of the host instrument and measured at fair value with changes therein recognized on the Consolidated Statement of Income.

Accrued interest receivable is recorded in other assets and accrued interest payable is recorded in accounts payable and accrued liabilities. Interest income or expense is recorded in interest income or interest expense, as applicable.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

3. Significant Accounting Policies (continued):

(b) Financial instruments – recognition and measurement (continued):

Hedge accounting

FirstOntario formally documents all relationships between hedging instruments and hedged items; as well as risk management objectives and strategies for undertaking various hedge transactions. This process includes linking all derivatives to specific assets and liabilities recognized on the Consolidated Statement of Financial Position or specific firm commitments or forecasted transactions that are highly probable to occur and prevent exposure to variations in cash flows that could ultimately affect reported net income. FirstOntario also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items attributable to the hedged risk. FirstOntario designates its interest rate hedge agreements as hedges of the underlying financial instrument.

IFRS specifies the criteria that must be satisfied in order for hedge accounting to be applied and prescribes the accounting treatment for those permitted hedging strategies applicable to FirstOntario – fair value hedges and cash flow hedges.

In a fair value hedge, the change in fair value of the hedging derivative is offset on the Consolidated Statement of Income by the change in fair value of the hedged item relating to the hedged risk. FirstOntario utilizes fair value hedges primarily to convert fixed rate financial assets and liabilities to floating rate. The main financial instruments designated in fair value hedging relationships are loans and mortgages. If the derivative expires or is sold, terminated or exercised, no longer meets the criteria for fair value hedge accounting, or the designation is revoked, hedge accounting is discontinued prospectively. The fair value of the hedged item related to the hedged risk is reported as other assets. The fair value of the hedging instrument is recorded as a derivative asset or liability.

In a cash flow hedge, the effective portion of changes in fair value of the derivative is recognized in other comprehensive income ("OCI") and presented in the cash flow hedging reserve in equity. The amount recognized in OCI is reclassified and included on the Consolidated Statement of Income in the same period that the hedged cash flows affect income. This will be offset by net interest income on assets and liabilities that are hedged. FirstOntario utilizes cash flow hedges primarily to convert floating rate assets and liabilities to fixed rate. Any hedge ineffectiveness is measured and is immediately recognized in the Consolidated Statement of Income.

When either a fair value or cash flow hedge is discontinued, any cumulative adjustment to either the hedged item or other comprehensive income (loss) is recognized in income over the remaining term of the original hedge (fair value hedge) and as the hedged item impacts earnings (cash flow hedge) or immediately if the forecast transaction is no longer expected to occur.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

3. Significant Accounting Policies (continued):

(c) Loan securitizations:

FirstOntario securitizes residential mortgages and commercial loans by legally selling them to funding partners. Securitized assets are assessed for derecognition under IFRS 9. When the derecognition criteria are met, the assets are derecognized from the Consolidated Statement of Financial Position.

Securitized residential mortgages that are assessed under IFRS 9 generally do not meet derecognition requirements as substantially all of the risks and rewards of the loans are held with FirstOntario. As a result, these loans are reported on the Consolidated Statement of Financial Position. Certain securitized residential mortgages subsequently met the derecognition criteria through the transfer of certain risks and rewards to external parties.

Commercial loans sold met the derecognition requirements and are not reported on the Consolidated Statement of Financial Position as substantially all of the risks and rewards of the loan are transferred to the funding partner and FirstOntario has received consideration in exchange. For those commercial loans sold, no gain is recorded as the consideration received is equivalent to the carrying value of the asset.

Revenue from servicing loans and mortgages is recorded as the services are provided.

(d) Cash and cash equivalents:

Cash and cash equivalents includes cash on hand, current accounts, short term deposits with other financial institutions, cheques and other items in transit. They are carried at amortized cost in the Statement of Financial Position.

(e) Investments:

Policy applicable from January 1, 2018

Investments include debt investment securities measured at amortized cost, debt and equity investment securities mandatorily measured at FVTPL or designated as at FVTPL, and equity investment securities designated as at FVOCI.

Policy applicable before January 1, 2018

Investments were recorded at fair value unless the investment was designated as Loans and Receivables. Any gains and losses on disposal of investments were recorded in the period they occurred and were included in other income in the Consolidated Statement of Income.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

3. Significant Accounting Policies (continued):

(f) Intangible assets:

Computer software that is not an integral part of other property is accounted for as intangible assets. Computer software is stated at cost less accumulated amortization and accumulated impairment losses and is presented as part of fixed assets in the Consolidated Statement of Financial Position. Amortization of computer software is calculated by applying the straight-line method at rates based on estimated useful lives between 3 and 14 years. Amortization methods and useful lives are reviewed at each reporting date and adjusted if appropriate.

(g) Fixed assets:

Fixed assets are stated at cost less accumulated amortization and accumulated impairment losses. When parts of an item of fixed assets have different useful lives, they are accounted for as separate items (major components) of fixed assets. Amortization is based on the cost of an asset less its residual value. Major components are amortized separately. Land is not amortized. Amortization on buildings and equipment is recognized in net income using the straight-line method at rates based on the estimated useful lives of the related assets and components as follows:

Asset	
Buildings	20 – 40 years
Parking lots and site improvements	10 – 25 years
Equipment	3 – 10 years
Leasehold improvements	Shorter of useful life and term of lease + one renewal period

Depreciation methods, useful lives and residual values are reviewed at each financial year-end and adjusted if appropriate.

(h) Investment properties:

Investment properties are properties held for rental, development and/or for capital appreciation. These investment properties are initially measured at cost and subsequently at fair value with any change therein recognized in profit or loss. Investment properties primarily consist of land and buildings held under joint venture agreements.

(i) Shares:

Membership and investment shares are classified either as liabilities or Members' equity. Where shares are redeemable at the option of the Member, either on demand or on withdrawal from membership, the shares are classified as liabilities and are measured at amortized cost. Shares that are redeemable at the discretion of FirstOntario's Board of Directors are classified as equity.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

3. Significant Accounting Policies (continued):

(j) Dividends:

Dividends on shares classified as liabilities are reported as interest expense. Dividends on shares classified as equity are charged to retained earnings on the date at which distributions are declared payable by the Board of Directors. All dividends on shares are deductible for income tax purposes.

(k) Impairment of non-financial assets:

Non-financial assets other than deferred tax assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable at each reporting date. An impairment loss is recognized for the amount by which the asset's carrying value exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. Impairment losses are recognized in net income.

Non-financial assets that have incurred impairment losses in prior years are reviewed for possible reversal of the impairment loss at each reporting date. A reversal of impairment is limited to the original impaired amount.

(l) Revenue recognition:

Loan interest and revenue is recognized in the Consolidated Statement of Income using the effective interest method. Refer to Note 3(b) for a detailed explanation of the effective interest method. Fee and commission income and expense that are integral to the effective interest rate on a financial asset or liability are included in the effective interest rate.

FirstOntario enters into contracts with Members to provide banking services and is under agency contracts to provide access to credit card and insurance products, and investment advisory services to its Members. These contracts outline the terms and conditions for the services provided and a corresponding schedule that details the fee and commission for each performance obligation and when it is to be received. These revenues are recognized as the related services are performed.

(m) Foreign exchange:

The Consolidated Financial Statements are presented in Canadian dollars, which is FirstOntario's functional currency. Monetary assets and liabilities denominated in foreign currencies, primarily US dollars, are translated into Canadian dollars at exchange rates prevailing at the year-end. Fixed assets and intangible assets are carried at the historical Canadian dollar cost. Income and expenses are translated at the exchange rates in effect on the date of the transactions. Exchange gains and losses arising on the translation of monetary assets and liabilities are included in other income.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

3. Significant Accounting Policies (continued):

(n) Provisions:

A provision is recognized if, as a result of a past event, FirstOntario has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.

(o) Employee retirement benefits:

FirstOntario provides retirement benefits to certain employees. These benefits include registered pension plans, medical benefits, dental care and life insurance.

A defined contribution plan is a pension plan under which FirstOntario pays contributions to a separate entity. FirstOntario has no legal or constructive obligation to pay further contributions after its payment of a contribution in accordance with the pension plan. Defined contribution pension plan contributions are expensed in the period during which services are rendered by employees.

A defined benefit plan is a pension plan that defines the amount of the pension benefit that an employee will receive upon retirement, usually dependent on one or more factors, such as age, years of service and compensation. Employment retirement benefits include both pension and other post-retirement benefits.

FirstOntario's net obligation in respect of defined benefit plans is calculated separately for each plan by estimating the amount of future benefit that employees have earned in the current and prior periods, discounting that amount and deducting the fair value of any plan assets.

The calculation of defined benefit obligations is performed annually by a qualified actuary using the projected unit credit method. When the calculation results in a potential asset for FirstOntario, the recognized asset is limited to the present value of economic benefits available in the form of any future refunds from the plan or reductions in future contributions to the plan. To calculate the present value of economic benefits, consideration is given to any applicable minimum funding requirements.

Remeasurements of the net defined benefit liability, which comprise actuarial gains and losses, the return on plan assets (excluding interest) and the effect of the asset ceiling (if any, excluding interest), are recognized immediately in OCI. FirstOntario determines the net interest expense (income) on the net defined benefit liability (asset) for the period by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the then-net defined benefit liability (asset), taking into account any changes in the net defined benefit liability (asset) during the period as a result of contributions and benefit payments. Net interest expense and other expenses related to defined benefit plans are recognized in salaries and benefits in net income.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

3. Significant Accounting Policies (continued):

(o) Employee retirement benefits (continued):

When the benefits of a plan are changed or when a plan is curtailed, the resulting change in benefit that relates to past service or the gain or loss on curtailment is recognized immediately in net income. FirstOntario recognizes gains and losses on the settlement of a defined benefit plan when the settlement occurs.

(p) Income taxes:

FirstOntario follows the asset and liability method of accounting for income taxes, whereby FirstOntario recognizes both the current and future income tax consequences of all transactions that have been recorded in the financial statements.

Current income taxes are the expected taxes refundable or payable on the taxable income for the year using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to taxes payable in respect of previous years. Current tax liabilities are classified as measured at amortized cost under IFRS 9.

Deferred income taxes provide for temporary differences between the carrying values of assets and liabilities and the amounts used for taxation purposes. The amount of deferred income tax provided is based on the expected timing of realization or settlement of the carrying value of assets and liabilities, using tax rates enacted or substantively enacted at the reporting period date. A deferred income tax asset is recognized only to the extent that it is probable that future taxable income will be available to utilize taxable benefits associated with the temporary difference in carrying value.

Deferred tax assets and liabilities are included either in other assets or accounts payable and accrued liabilities, as applicable, in the Consolidated Statement of Financial Position.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

4. New Standards and Interpretations not yet effective:

Future changes in accounting policy:

- (a) On January 13, 2016 the IASB issued *IFRS 16 Leases*. The new standard is effective for annual periods beginning on or after January 1, 2019. IFRS 16 will replace IAS 17 *Leases*.

This standard introduces a single lessee accounting model and requires a lessee to recognize assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognize a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments.

This standard substantially carries forward the lessor accounting requirements of IAS 17, while requiring enhanced disclosures to be provided by lessors. Other areas of the lease accounting model have been impacted, including the definition of a lease.

FirstOntario will adopt IFRS 16 in its financial statements for the annual period beginning on January 1, 2019. It is expected that IFRS 16 will have an impact on the financial results of FirstOntario as follows: As at January 1, 2019, assets will increase by approximately \$19,800,000, liabilities will increase by approximately \$20,600,000, and retained earnings will decrease by approximately \$650,000, net of tax.

- (b) On May 18, 2017 the IASB issued *IFRS 17 Insurance Contracts*.

The new standard is effective for annual periods beginning on or after January 1, 2021. IFRS 17 will replace IFRS 4 *Insurance Contracts*.

This standard introduces consistent accounting for all insurance contracts. The standard requires a company to measure insurance contracts using updated estimates and assumptions that reflect the timing of cash flows and any uncertainty relating to insurance contracts. Additionally, IFRS 17 requires a company to recognize profits as it delivers insurance services, rather than when it receives premiums.

FirstOntario intends to adopt IFRS 17 in its financial statements for the annual period beginning on January 1, 2021. The extent of the impact of adoption of the standard has not yet been determined.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

5. Loans Receivable from Members:

Loans receivable from Members, which are classified as amortized cost or FVTPL (from January 1, 2018) and designated as loans and receivables (before January 1, 2018), are as follows:

(In thousands of dollars)	2018 IFRS 9	2017 IAS 39
Residential mortgage loans	\$ 2,723,704	\$ 2,438,043
Allowance for impaired loans	(886)	(632)
	2,722,818	2,437,411
Personal loans	120,514	130,437
Allowance for impaired loans	(1,645)	(2,150)
	118,869	128,287
Commercial loans	753,140	813,482
Allowance for impaired loans	(5,575)	(4,703)
	747,565	808,779
	\$ 3,589,252	\$ 3,374,477

FirstOntario classifies residential mortgage loans that do not meet the business model assessment of held to collect as FVTPL. At December 31, 2018, FirstOntario has classified \$nil (2017 - \$nil) residential mortgage loans as measured at FVTPL.

Certain residential mortgage loans are securitized and have been legally transferred to other entities for funding purposes. These loans are administered by FirstOntario and recognized on the Consolidated Statement of Financial Position to the extent of FirstOntario's continuing involvement. A summary of the carrying values of residential mortgage loans is as follows:

(In thousands of dollars)	2018	2017
Loans held by FirstOntario	\$ 2,201,754	\$ 1,679,720
Loans held by Securitization Trusts	521,950	758,323
	\$ 2,723,704	\$ 2,438,043

Additional details are provided in Note 8 related to FirstOntario's securitization activity.

Interest income for the year is as follows:

(In thousands of dollars)	2018	2017
Residential mortgage loans	\$ 83,518	\$ 70,966
Personal loans	6,653	6,834
Commercial loans	39,603	38,736
	\$ 129,774	\$ 116,536

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

5. Loans Receivable from Members (continued):

Total fees paid to third parties associated with lending activities capitalized in other assets were \$11,006,000 as at December 31, 2018 (2017 - \$11,748,000). Charges amortized into interest expense in respect of these fees were \$7,031,000 during the year ended December 31, 2018 (2017 - \$6,448,000).

The following summarizes FirstOntario's loan portfolio by the contractual repricing or maturity date, whichever is earlier:

(In thousands of dollars)	2018		2017	
	Principal Balance	Average Yield	Principal Balance	Average Yield
Floating	\$ 654,818	5.31%	\$ 695,133	4.51%
Within 1 year	898,356	4.35%	558,920	4.11%
Over 1 year	2,044,184	3.59%	2,127,909	3.54%
	3,597,358	4.09%	3,381,962	3.84%
Provision for loan losses	(8,106)		(7,485)	
	\$ 3,589,252		\$ 3,374,477	

6. Allowance for Impaired Loans:

Policy applicable from January 1, 2018

FirstOntario applies the three stage approach to measure the allowance for credit losses, using the ECL approach as required under IFRS 9. The allowance is calculated based on the stage in which the financial asset falls at the reporting date. The financial assets migrate through the three stages based on the change in their risk of default since initial recognition.

ECL calculations are outputs of an ECL model with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. The ECL impairment model reflects the present value of all cash shortfalls related to default events either (i) over the following twelve months or (ii) over the expected life of the financial instrument, depending on the credit deterioration since its inception. The model reflects an unbiased, probability-weighted credit loss which considers multiple scenarios based on reasonable and supportable information about past events, current conditions and forecasts of future economic conditions. Forward looking information is explicitly incorporated into the estimation of ECL.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

6. Allowance for Impaired Loans (continued):

The three stages of the allowance for credit losses are:

Stage 1 – Where there has not been a significant increase in credit risk (“SICR”) since initial recognition of a financial asset, an amount equal to 12 months ECL is recorded. The ECL is computed using a probability of default (“PD”) occurring over the next 12 months.

Stage 2 – When a financial asset experiences a SICR subsequent to initial recognition but is not considered to be in default, it is included in Stage 2. This requires the computation of ECL based on the PD over the remaining estimated life of the financial asset.

Stage 3 – Financial assets that are considered to be in default are included in this stage. Similar to Stage 2, the allowance captures lifetime ECL.

The probability of default, exposure at default (“EAD”), and loss given default (“LGD”) are inputs used to estimate the ECL, and are modelled based on macroeconomic factors that are closely related with credit losses in the relevant portfolios, and are probability weighted using three scenarios. The measurement of ECL is based primarily on the product of the three variables:

- PD is an estimate of the likelihood of default over a given time horizon
- EAD is the expected exposure (balance of the loan plus accrued interest) in the event of default at a future default date
- LGD is an estimate of the loss arising where a default occurs at a given time and is based on the difference between the contractual cash flows due and those that FirstOntario would expect to receive, including from the realization of any collateral.

Assessment of significant increase in credit risk

The measurement of ECL for each stage and the assessment of SICR considers information about past events and current conditions as well as supportable forecasts of future events and economic conditions. The estimation and application of forward-looking information (“FLI”) requires significant judgement. FirstOntario relies on a broad range of FLI’s, such as expected real GDP, unemployment rates, house price indices, interest rates and debt ratios. The inputs used in the model for calculating ECL may not always capture all characteristics of the market at the reporting date. To capture portfolio characteristics and risks, adjustments are made using management judgement.

When determining whether the risk of default on a financial asset has increased significantly since initial recognition, FirstOntario considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis, based on FirstOntario’s historical experience and expert credit assessment, delinquency and monitoring, and macroeconomic outlook including FLI. There is a rebuttable presumption that the risk of default has increased since initial recognition when contractual payments are more than 30 days overdue.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

6. Allowance for Impaired Loans (continued):

A summary of the loan allowance for expected credit losses is as follows:

(In thousands of dollars)	12-month ECL (Stage 1)	Lifetime ECL- Non-credit Impaired (Stage 2)	Lifetime ECL- Credit Impaired (Stage 3)	IFRS 9 2018 Total
Balance at beginning of year				\$ 7,485
Change on initial application of IFRS 9 (Note 22)				(473)
Restated balance at beginning of year	\$ 2,604	\$ 2,327	\$ 2,081	\$ 7,012
Transfer to (from):				
Stage 1	1,563	(1,491)	(72)	-
Stage 2	(74)	96	(22)	-
Stage 3	(24)	(29)	53	-
Re-measurement	(1,288)	559	4,113	3,384
Originations	1,060	-	103	1,163
Loans derecognized	(817)	(522)	(763)	(2,102)
Loans written-off	-	-	(1,518)	(1,518)
Recoveries	-	-	167	167
Balance at end of year	\$ 3,024	\$ 940	\$ 4,142	\$ 8,106

Provision for impaired loans amounting to \$2,445,000 is comprised of ECL related to re-measurement changes of \$3,384,000 and loan originations of \$1,163,000 less loans derecognized of \$2,102,000.

2018				
IFRS 9				
(In thousands of dollars)	Residential Mortgage Loans	Personal Loans	Commercial Loans	Total
Balance at beginning of year	\$ 632	\$ 2,150	\$ 4,703	\$ 7,485
Change on initial application of IFRS 9 (Note 22)	124	(251)	(346)	(473)
Restated balance at beginning of year	756	1,899	4,357	7,012
Loans written off	-	(685)	(833)	(1,518)
Recoveries	-	167	-	167
Net provision for loan allowance	130	264	2,051	2,445
Balance at end of year	\$ 886	\$ 1,645	\$ 5,575	\$ 8,106

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

6. Allowance for Impaired Loans (continued):

					2017
					IAS 39
(In thousands of dollars)	Residential Mortgage Loans	Personal Loans	Commercial Loans	Collective Allowance	Total
Balance at beginning of year	\$ 112	\$ 744	\$ 587	\$ 6,015	\$ 7,458
Loans written off	(134)	(698)	(1,065)	-	(1,897)
Recoveries	-	282	-	-	282
Net provision for impaired loans	68	347	1,163	64	1,642
Balance at end of year	\$ 46	\$ 675	\$ 685	\$ 6,079	\$ 7,485

A summary of impaired loans are as follows:

				2018	2017
(In thousands of dollars)	Residential Mortgage Loans	Personal Loans	Commercial Loans	Total	Total
Gross amount of loans identified as impaired	\$ 22,925	\$ 906	\$ 18,707	\$ 42,538	\$ 22,506
Related security less expected costs	22,531	437	15,428	38,396	21,100
ECL (2018), Specific provision (2017)	\$ 394	\$ 469	\$ 3,279	\$ 4,142	\$ 1,406

A summary of loans past due but not impaired are as follows:

				2018	2017
(In thousands of dollars)	<30 days	30-59 days	60-89 days	Total	Total
Residential mortgage loans	\$ 68,940	\$ 15,655	\$ 2,462	\$ 87,057	\$ 77,357
Personal loans	2,902	544	229	3,675	5,065
Commercial loans	22,400	-	-	22,400	11,621
Balance at end of year	\$ 94,242	\$ 16,199	\$ 2,691	\$ 113,132	\$ 94,043

The carrying amount of loans that were renegotiated during the year that otherwise would have been listed as past due greater than 90 days were \$nil (2017 - \$nil).

FirstOntario's commercial loan portfolio contains Member concentration risk, whereby a large amount of the loans are connected to certain individuals. Collectively, the largest five commercial Members by loan dollar value are associated with approximately 17% (2017 - 15%) of the commercial loan portfolio.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

6. Allowance for Impaired Loans (continued):

FirstOntario's commercial loan portfolio consists of the following industry sectors:

	2018	2017
Hospitality	24%	24%
Retail & Commercial Buildings	53%	51%
Other	23%	25%

Collateral

There are documented policies and procedures in place for the valuation of financial and non-financial collateral. The fair value of non-financial collateral is updated if there has been a significant change in the terms and conditions of the loan and (or) the loan is considered impaired. For impaired loans, an assessment of the collateral is taken into consideration when estimating the expected future cash flows and net realizable amount of the loan.

The amount and type of collateral and other credit enhancements required depend upon FirstOntario's assessment of counterparty credit quality and repayment capacity. FirstOntario complies with industry standards for collateral valuation, frequency of recalculation of the collateral requirements, documentation, registration and perfection procedures, and monitoring. Non-financial assets accepted by FirstOntario as collateral include vehicles, residential real estate, real estate under development, commercial real estate and certain business assets (accounts receivable, inventory, and fixed assets). Financial collateral includes cash and negotiable securities issued by governments and investment grade issuers. Guarantees are also accepted to reduce credit risk.

At December 31, 2018, the net carrying amount of credit-impaired loans amounted to \$38,386,000 (2017 - \$21,100,000) and the value of identifiable collateral (mainly commercial properties) held against those loans amounted to \$41,622,000 (2017 - \$20,595,000). For each loan, the value of disclosed collateral is capped to the nominal amount of the loan that it is held against.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

6. Allowance for Impaired Loans (continued):

The following table illustrates the credit quality of loans:

(In thousands of dollars)	12-month ECL (Stage 1)	Lifetime ECL- Non-credit Impaired (Stage 2)	Lifetime ECL- Credit Impaired (Stage 3)	2018	2017
<i>Retail Mortgages and Personal Loans</i>					
Unscored	\$ 19,525	\$ 381	\$ 101	\$ 20,007	\$ 54,417
A+	746,759	2,499	953	750,211	47,127
A	1,541,690	1,953	7,549	1,551,192	1,050,459
B	179,013	1,348	1,224	181,585	612,341
C	186,567	18,750	3,203	208,520	396,540
D	53,711	23,024	2,688	79,423	241,884
E	15,702	29,465	8,113	53,280	165,712
<i>Commercial Loans</i>					
Undoubted	-	-	-	-	-
Superior	6,688	-	-	6,688	11,121
Satisfactory	718,737	9,008	-	727,745	782,237
Watch list	-	-	18,707	18,707	20,124
Gross loan balance	3,468,392	86,428	42,538	3,597,358	3,381,962
Allowance for impairment loans	(3,024)	(940)	(4,142)	(8,106)	(7,485)
Carrying amount	\$3,465,368	\$ 85,488	\$ 38,396	\$3,589,252	\$3,374,477

Refer to Note 16 – Financial Risk Management for a detailed explanation of the credit risk rating process of both portfolios.

7. Cash and Cash Equivalents:

(In thousands of dollars)	2018	2017
Cash on hand	\$ 11,329	\$ 11,088
Cash at Central 1	50,503	30,484
Other cash and cash equivalents	485	1,526
Total cash and cash equivalents	\$ 62,317	\$ 43,098

8. Loan Securitizations:

FirstOntario enters into transactions in the normal course of business by which it transfers recognized financial assets directly to third parties or Special Purpose Entities (“SPE’s”). FirstOntario securitizes mortgage backed securities through programs sponsored by the Canada Mortgage and Housing Corporation and other third party programs.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

8. Loan Securitizations (continued):

Certain transactions allow FirstOntario to transfer its contractual right to receive cash flows from the financial assets, or retain the right but assume an obligation to pass on the cash flows from the asset, and transfer substantially all the risks and rewards of ownership. The risks include credit, interest rate, prepayment and other price risks. Under these conditions, the residential or commercial mortgages included in the mortgage backed security meet the qualifications required to be derecognized under IFRS.

Residential and commercial mortgages that have been derecognized are those that meet the qualifications required to be derecognized under IFRS.

The following table summarizes FirstOntario's securitization activity during the years ended December 31, 2018 and December 31, 2017:

(In thousands of dollars)	2018		2017	
	Residential Mortgages	Commercial Mortgages	Residential Mortgages	Commercial Mortgages
Amount securitized/sold	\$ 182,874	\$ 347,929	\$ 272,384	\$ 384,068
Net cash proceeds received	181,968	338,771	270,692	378,556
Outstanding balances of securitized loans	1,356,190	1,819,164	1,514,150	1,559,525

The following table summarizes the balances for securitized loans that are not recorded on the Statement of Financial Position:

(In thousands of dollars)	2018		2017	
	Residential Mortgages	Commercial Mortgages	Residential Mortgages	Commercial Mortgages
Retained rights and receivables	\$ 12,526	\$ 25,154	\$ 15,178	\$ 24,370
Outstanding balances of off-balance sheet securitized loans	834,240	1,819,164	755,827	1,559,525

Retained rights are reported as investments on the Consolidated Statement of Financial Position (Note 9). The following table summarizes the weighted average key assumptions at the date of off-balance sheet securitization for retained rights related to all residential and commercial mortgages sold and derecognized under IFRS 9 (2017 - IAS 39).

	2018	2017
Average life	4.9 years	5.3 years
Prepayment rate	0.15%	0.00%
Discount rate	2.06%	1.93%
Expected credit losses	0.00%	0.00%

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

9. Investments:

Investments are as follows:

(In thousands of dollars)	2018	2017
<i>Equity securities measured at FVOCI:</i>		
Shares – Central 1 (d)	\$ 18,308	\$ -
Preferred shares	2,009	-
<i>Equity securities measured at FVTPL:</i>		
Managed funds (b)	76,830	25,151
Investment in private equity funds	4,500	-
Shares – other	1,250	-
CUCO Co-operative Association (c)	87	87
<i>Debt securities measured at FVTPL:</i>		
Retained rights – loan securitizations	37,680	-
<i>Debt securities measured at amortized cost:</i>		
Liquidity reserve deposits	256,605	-
Loans	10,779	-
<i>Held-to-maturity debt securities:</i>		
Liquidity reserve deposits	-	240,181
<i>Available-for-sale debt securities:</i>		
Retained rights – loan securitizations	-	39,548
<i>Available-for-sale equity securities:</i>		
Shares – Central 1(d)	-	19,275
Shares – other	-	1,250
Preferred shares	-	2,073
Loans and receivables	-	5,658
Investments measured under IFRS 9 (2018), IAS 39 (2017)	408,048	333,223
Real estate joint ventures (e)	87,465	74,631
Other investments	340	442
	\$ 495,853	\$ 408,296

The following summarizes FirstOntario's investments by the contractual repricing or maturity date, whichever is earlier:

(In thousands of dollars)	2018 Carrying Amount	2018 Average Yield	2017 Carrying Amount	2017 Average Yield
Within 1 year	\$ 50,332	1.81%	\$ 32,901	1.98%
Over 1 year	204,610	1.68%	205,632	1.52%
	254,942	1.70%	238,533	1.58%
Non-rate sensitive	239,173		168,115	
Accrued interest	1,738		1,648	
	\$ 495,853		\$ 408,296	

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

9. Investments (continued):

(a) Equity investments designated as at FVOCI:

(In thousands of dollars)		2018
Interest and investment income	\$	660
Unrealized pre-tax gain/loss recognized in OCI		-

Financial instruments classified as AFS (IAS 39):

The following table presents the income and losses of the financial assets classified as AFS:

(In thousands of dollars)		2017
Interest and investment income	\$	93
Unrealized pre-tax loss recognized in OCI		(17)

(b) Managed funds:

FirstOntario holds certain investments within actively managed investment funds issued by external investment providers. Given the investments are actively managed by investment advisors, these investments are held for trading and are measured at FVTPL. During the year, \$45,097,000 (2017 - \$2,500,000) was invested into these investments and net fair value and foreign exchange changes of \$6,582,000 (2017 - \$1,716,000) were recognized in the Consolidated Statement of Income as other income.

(c) CUCO Cooperative Association:

FirstOntario holds 5.8% of Class B Investment Shares in CUCO Cooperative Association ("CUCO Co-op"). These investments are measured at FVTPL. CUCO Co-op previously held investments in certain third party asset-backed commercial paper ("ABCP"). During 2017, CUCO Co-op disposed of the remaining ABCP investments. The CUCO Co-op Class B Shares are being carried at \$87,000 (2017 - \$87,000) representing FirstOntario's share of expected final returns that will be disbursed on wind-up. During the 2018 fiscal period, the fair value of the shares increased by \$nil (2017 - \$12,000).

(d) Central 1 shares:

As a member of Central 1, FirstOntario is required to maintain an investment in Central 1 shares based on FirstOntario's asset size relative to other Class A members. Central 1 rebalances their shares annually. During 2018, as part of this share rebalancing, FirstOntario was required to purchase nil (2017 - 2,774,213) Central 1 Class A shares and 432,256 (2017 - nil) Central 1 Class F shares. In addition, Central 1 returned a portion of the shares redeeming 114,616 (2017 - nil) Central 1 Class A shares and 256,011 (2017 - nil) Central 1 Class F shares. FirstOntario received \$567,000 (2017 - \$530,000) in dividends in 2018.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

9. Investments (continued):

(d) Central 1 shares (continued):

A share restructuring during the year resulted in the issuance of 12,639,856 (2017 - nil) Central 1 Class F shares to FirstOntario, and the redemption of 12,347,247 (2017 – 980,035) Central 1 Class A shares and 13,211 (2017 – 2,643) Central 1 Class E shares.

The following table summarizes the investment in Central 1 Shares as at December 31, 2018:

(In thousands of dollars)	2018	2017
1,518,183 Central 1 Class "A" Shares (2017 - 13,980,046)	\$ 1,518	\$ 13,980
39,736 Central 1 Class "E" Shares (2017 - 52,947)	3,974	5,295
12,816,101 Central 1 Class "F" Shares (2017 - nil)	12,816	-
	\$ 18,308	\$ 19,275

FirstOntario has designated the Central 1 shares as measured at FVOCI as FirstOntario intends to hold these shares for the long term.

Central 1 requires that member credit unions maintain with them liquidity and secondary liquidity reserve deposits equal to 6% of the member credit union's assets. These reserve deposits are determined on a monthly basis and are classified as measured at amortized cost.

(e) Real estate joint ventures:

FirstOntario periodically enters into agreements with third parties to jointly control investment properties. These joint ventures are initially measured at cost and subsequently at fair value with any change therein recognized in profit or loss. Costs include initial acquisition costs and other costs incurred prior to the real estate being ready for its intended use.

(In thousands of dollars)	2018	2017
Balance at the beginning of year	\$ 74,631	\$ 54,705
Acquisitions	7,628	17,791
Earnings from joint ventures	1,758	1,278
Distributions	(1,815)	(2,174)
Change in fair value	5,263	3,031
Balance at the end of year	\$ 87,465	\$ 74,631

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

9. Investments (continued):

(e) Real estate joint ventures (continued):

FirstOntario's portion of the revenue and expenses from participation in the ventures has been included in other income as follows:

(In thousands of dollars)	2018	2017
Revenues	\$ 7,169	\$ 5,981
Expenses	5,411	4,703
Earnings from joint ventures	\$ 1,758	\$ 1,278

The expenses of the joint ventures included amortization in the amount of \$1,494,000 (2017 - \$1,165,000). Operating cash flow generated by the ventures was \$1,787,000 (2017 - \$1,705,000). During the year ended December 31, 2018, FirstOntario received \$1,815,000 (2017 - \$2,174,000) in distributions from the ventures.

Investments properties held under the ventures is as follows:

(In thousands of dollars)	2018	2017
Real estate held at fair value for investment purposes	\$ 70,037	\$ 63,860
Construction in progress	17,428	10,771
Balance at the end of year	\$ 87,465	\$ 74,631

Fair value was determined by experienced registered independent appraisers having an appropriate recognized professional qualification. The fair value measurement for all of the joint ventures has been categorized as a level 3 fair value based on the inputs of the valuation technique used (see Note 17).

Joint venture values were based on the appraiser's opinion of value having undertaken the following approaches:

- The Income Approach method where the investment is expected to be acquired by an investor basing criteria on an expected income flow.
- The Direct Comparison Approach method which determines the market range of unit prices demonstrated by the sales or listings of comparable properties.

Below is a summary of the significant unobservable inputs used in the modeling process:

	2018	2017
Capitalization rate	5.7 - 7.5%	6.3% - 7.3%
Risk-adjusted discount rate	8.3%	8.3%
Occupancy rate	89% - 98%	91% - 98%
Vacancy periods (average months after end of each lease)	2 - 6 months	5 months

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

9. Investments (continued):

(e) Real estate joint ventures (continued):

Other significant unobservable inputs are the expected market rental growth rate and the rent-free periods.

The estimated fair value of the joint ventures would increase (decrease) as a result of the following changes in the significant unobservable inputs:

	Change
Capitalization rate	lower (higher)
Risk-adjustment discount rate	lower (higher)
Occupancy rate	higher (lower)
Void periods	shorter (longer)
Expected market rental growth	higher (lower)
Rent-free periods	shorter (longer)

10. Fixed Assets:

(In thousands of dollars)	Cost	Accumulated amortization	2018 Net book value
Land	\$ 1,321	\$ -	\$ 1,321
Parking lots/Site improvements	348	258	90
Buildings	6,542	3,490	3,052
Equipment	19,581	13,249	6,332
Leasehold improvements	21,396	10,339	11,057
Tangible assets	49,188	27,336	21,852
Intangible assets (software)	30,342	13,085	17,257
Total fixed assets	\$ 79,530	\$ 40,421	\$ 39,109

(In thousands of dollars)	Cost	Accumulated amortization	2017 Net book value
Land	\$ 1,321	\$ -	\$ 1,321
Parking lots/Site improvements	348	245	103
Buildings	6,351	3,264	3,087
Equipment	17,879	11,577	6,302
Leasehold improvements	20,130	8,735	11,395
Tangible assets	46,029	23,821	22,208
Intangible assets (software)	27,345	11,352	15,993
Total fixed assets	\$ 73,374	\$ 35,173	\$ 38,201

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

10. Fixed Assets (continued):

Amortization in respect of the above assets for the year ended December 31, 2018 amounts to \$5,277,000 (2017 - \$4,998,000).

Reconciliations of the net book value for each class of fixed asset are summarized below:

(In thousands of dollars)	2018	2017
<u>Land</u>		
Net book value at the beginning of the year	\$ 1,321	\$ 1,321
Additions	-	-
Disposals	-	-
Net book value at the end of the year	1,321	1,321
<u>Parking lots/Site improvements</u>		
Net book value at the beginning of the year	103	119
Additions	-	-
Amortization	(13)	(16)
Net book value at the end of the year	90	103
<u>Buildings</u>		
Net book value at the beginning of the year	3,087	3,285
Additions	191	30
Amortization	(226)	(228)
Net book value at the end of the year	3,052	3,087
<u>Equipment</u>		
Net book value at the beginning of the year	6,302	6,647
Additions	1,702	1,588
Disposals	-	(103)
Amortization	(1,672)	(1,830)
Net book value at the end of the year	6,332	6,302
<u>Leasehold improvements</u>		
Net book value at the beginning of the year	11,395	11,911
Additions	1,331	1,039
Disposals	(36)	-
Amortization	(1,633)	(1,555)
Net book value at the end of the year	11,057	11,395

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

10. Fixed Assets (continued):

(In thousands of dollars)	2018	2017
<u>Intangible assets (software)</u>		
Net book value at the beginning of the year	\$ 15,993	\$ 12,432
Additions	2,997	4,941
Disposals	-	(11)
Amortization	(1,733)	(1,369)
Net book value at the end of the year	17,257	15,993
Total net book value	\$ 39,109	\$ 38,201

11. Members' Deposits:

Members' deposits, which are classified as amortized cost (from January 1, 2018) and designated as other liabilities (before January 1, 2018), are as follows:

(In thousands of dollars)	2018	2017
Chequing	\$ 385,850	\$ 346,685
Savings	656,698	687,757
Term deposits	1,575,049	1,118,452
Registered plans	671,641	631,452
	\$ 3,289,238	\$ 2,784,346

Included in registered plans and term deposits are \$3,217,000 in Equity-Linked Deposits at December 31, 2018 (2017 - \$3,598,000). See Note 15 for the related derivatives used to hedge exposure to equity market risk.

Concentra Financial Services Association acts as the trustee for the majority of FirstOntario's tax deferred savings plans (registered retirement savings plans and registered retirement income funds). FirstOntario accepts deposits on behalf of the trustee and retains the funds deposited.

Interest expense for the year is as follows:

(In thousands of dollars)	2018	2017
Savings	\$ 7,861	\$ 7,987
Term deposits	30,581	18,114
Registered plans	12,496	11,104
	\$ 50,938	\$ 37,205

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

11. Members' Deposits (continued):

The following summarizes FirstOntario's Members' deposits by the contractual repricing or maturity date, whichever is earlier:

(In thousands of dollars)	2018		2017	
	Principal Balance	Average Yield	Principal Balance	Average Yield
Floating	\$ 732,020	1.31%	\$ 757,329	1.35%
Within 1 year	1,286,038	2.45%	1,146,233	1.98%
Over 1 year	781,530	2.82%	436,877	2.25%
	2,799,588	2.26%	2,340,439	1.83%
Non-rate sensitive	489,650		443,907	
	\$ 3,289,238		\$ 2,784,346	

12. Membership and Investment Shares:

Authorized Share Capital

FirstOntario has authorized an unlimited number of membership shares. Such shares are issued for \$5 each and Members under the age of 21 must hold one membership share while those 21 and over are required to hold at least five shares and increase their holdings of membership shares to 30 shares over a 25 year period. Membership shares are redeemable, on withdrawal from membership, at the amount paid thereon provided FirstOntario is meeting the "capital adequacy" requirements (see Note 13) and they rank junior to Class A and Class B special shares for priority in the payment of dividends.

An unlimited number of Class A and Class B special shares. Such shares are generally non-voting and non-participating with non-cumulative dividend entitlements. In respect of dividends, both classes rank senior to the membership shares and the Class B special shares rank ahead of the Class A special shares.

The Board of Directors has authorized a Series 1, Series 2, Series 2013, Series 2010 and Series 2015 for Class B special shares ("investment shares"). The investment shares have an issue price of \$1 each and are entitled to receive dividends if, as and when declared by the Board of Directors. Series 1, Series 2 and Series 2013 investment shares are redeemable at the holder's request. Series 2010 investment shares are redeemable at the sole and absolute discretion of the Board of Directors. Series 2015 investment shares are redeemable at the sole and absolute discretion of the Board of Directors starting in 2020. In any year, redemptions are restricted to 10% of the respective series of the outstanding investment shares.

Issued and Outstanding

Membership shares and Series 1, 2 and 2013 investment shares are classified as liabilities and are measured at amortized cost from January 1, 2018, and were designated as other liabilities before 2018. Dividends are recorded using the effective interest rate method. Series 2010 and 2015 investment shares are classified as equity as these shares are redeemable at the sole and absolute discretion of the Board of Directors.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

12. Membership and Investment Shares (continued):

Issued and Outstanding (continued):

(In thousands of dollars)	2018	2017
Membership shares		
1,842,545 (2017 - 1,718,220) membership shares	\$ 9,213	\$ 8,591
Investment shares		
5,214,168 (2017 - 5,247,873)		
Class B, Series 1, Special Shares	5,214	5,248
6,263,230 (2017 - 6,479,531)		
Class B, Series 2, Special Shares	6,263	6,480
948,056 (2017 - 940,422)		
Class B, Series 2013, Special Shares	948	940
Investment shares classified as liabilities	12,425	12,668
45,121,199 (2017 - 44,067,140)		
Class B, Series 2010, Special Shares	44,875	43,820
62,312,494 (2017 - 60,641,128)		
Class B, Series 2015, Special Shares	62,059	60,388
Investment shares classified as equity	106,934	104,208
	\$ 119,359	\$ 116,876

Dividends

Dividends earned by membership and investment shares classified as liabilities and expensed on the Consolidated Statement of Income were as follows:

(In thousands of dollars)	2018	2017
Membership shares	\$ 650	\$ 456
Series 1, 2 and 2013 investment shares	500	540
Dividends on membership and investment shares	1,150	996
Dividends on Series 2010 and 2015 shares (classified as equity)	\$ 4,217	\$ 1,404

On March 15, 2018, the Board of Directors approved the issue of 505,023 Series 1, 2 and 2013 investment shares, 1,764,544 Series 2010 investment shares and 2,452,774 Series 2015 investment shares in payment of a dividend for the 12 months from January 1, 2017 to December 31, 2017.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

12. Membership and Investment Shares (continued):

The tables that follow present a reconciliation of the change in shares during the year:

	2018	2017
<u>Membership Shares</u>		
Opening balance	1,718,220	1,621,024
Shares issued during the year	181,501	111,832
Shares redeemed	(57,176)	(14,636)
Membership shares	1,842,545	1,718,220
<u>Class B, Series 1, Special Shares</u>		
Opening balance	5,247,873	5,305,273
Shares issued during the year	206,464	233,495
Shares redeemed	(240,169)	(290,895)
Class B, Series 1, Special Shares	5,214,168	5,247,873
<u>Class B, Series 2, Special Shares</u>		
Opening balance	6,479,531	6,593,038
Shares issued during the year	260,924	290,233
Shares redeemed	(477,225)	(403,740)
Class B, Series 2, Special Shares	6,263,230	6,479,531
<u>Class B, Series 2013, Special Shares</u>		
Opening balance	940,422	926,851
Shares issued during the year	37,635	40,788
Shares redeemed	(30,001)	(27,217)
Class B, Series 2013, Special Shares	948,056	940,422

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

12. Membership and Investment Shares (continued):

	2018	2017
<u>Class B, Series 2010, Special Shares</u>		
Opening balance	44,067,140	43,615,163
Shares issued during the year	1,764,544	590,533
Shares redeemed	(710,485)	(138,556)
Class B, Series 2010, Special Shares	45,121,199	44,067,140
<u>Class B, Series 2015, Special Shares</u>		
Opening balance	60,641,128	60,130,954
Shares issued during the year	2,452,774	813,875
Shares redeemed	(781,408)	(303,701)
Class B, Series 2015, Special Shares	62,312,494	60,641,128

13. Regulatory Reporting and Disclosure:

(a) Capital management:

FirstOntario maintains policies and procedures relative to capital management so as to ensure that capital levels are sufficient to cover risks inherent in the business.

FirstOntario's objectives when managing capital are:

- (i) To ensure that the quantity, quality and composition of capital required reflects the inherent risks of FirstOntario and to support the current and planned operations and portfolio growth.
- (ii) To provide a basis for confidence among Members, depositors, creditors and regulatory agencies.
- (iii) To ensure that FirstOntario maintains a level of capital that sufficiently protects against unanticipated losses and to comply with the minimum regulatory capital requirements set out in the Act.

Regulatory capital is calculated as a percentage of total assets and of risk-weighted assets. Risk-weighted assets are calculated by applying risk weight percentages, as prescribed by the Act, to various asset categories, operational and interest rate risk criteria. The prescribed risk weights are dependent upon the degree of risk associated with the asset.

FirstOntario manages its Tier 1 and Tier 2 capital in accordance with internal policies and regulatory requirements. Tier 1 capital is the highest quality and consists of retained earnings, contributed surplus, accumulated other comprehensive losses, membership shares and the portion of the value of Class B investment shares that are not redeemable within 12 months. Tier 2 capital is comprised of the value of Class B investment shares ineligible as Tier 1 capital and the eligible portion of the allowance for impaired loans.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

13. Regulatory Reporting and Disclosure (continued):

(a) Capital management (continued):

The amount and composition of Tier 1 and Tier 2 capital were as follows:

(In thousands of dollars)	2018	2017
<u>Tier 1 Capital</u>		
Retained earnings	\$ 116,784	\$ 111,323
Contributed surplus	4,865	4,865
Membership shares	9,213	8,591
Class B Investment Shares, Series 1 (90%)	4,693	4,723
Class B Investment Shares, Series 2 (90%)	5,637	5,832
Class B Investment Shares, Series 2010 (90%)	40,388	39,438
Class B Investment Shares, Series 2013 (90%)	853	846
Class B Investment Shares, Series 2015 (100%)	62,059	60,388
Total Tier 1 Capital	244,492	236,006
<u>Tier 2 Capital</u>		
Class B Investment Shares, Series 1 (10%)	521	525
Class B Investment Shares, Series 2 (10%)	626	648
Class B Investment Shares, Series 2010 (10%)	4,488	4,382
Class B Investment Shares, Series 2013 (10%)	95	94
Accumulated other comprehensive losses – employee benefit adjustments	(1,627)	(2,855)
Stage 1 and 2 ECL/Collective allowance for impaired loans	3,964	6,079
Total Tier 2 Capital	8,067	8,873
Total Regulatory Capital	\$ 252,559	\$ 244,879

Under the Regulations of the Act, FirstOntario must maintain minimum levels of regulatory capital. The leverage ratio calculates regulatory capital as a percentage of assets. The risk-weighted capital ratio calculates regulatory capital as a percentage of risk-weighted assets. FirstOntario complied with these requirements as follows:

	Regulatory Capital	Leverage Ratio		Risk-Weighted Capital Ratio	
		Minimum	Actual	Minimum	Actual
2018	\$ 252,559,000	4.00%	5.99%	8.00%	12.37%
2017	244,879,000	4.00%	6.29%	8.00%	13.02%

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

13. Regulatory Reporting and Disclosure (continued):

(b) Remuneration of officers and employees:

The Act requires disclosure of the five highest paid officers and employees of FirstOntario where total remuneration exceeds \$150,000. The names, positions and remuneration paid during the 12 months ended December 31, 2018 of those officers and employees are as follows:

	Salary	Benefits	Total
Kelly McGiffin, Chief Executive Officer	\$ 710,000	\$ 91,000	\$ 801,000
James Olson, President	439,000	31,000	470,000
Lloyd Smith, Divisional Chief Executive Officer, Corporate Investments	404,000	39,000	443,000
Barry Doan, Chief Financial Officer	400,000	39,000	439,000
David Schurman, Chief Risk Officer	400,000	34,000	434,000

Remuneration is fair and competitive with salaries of similar positions at credit unions of approximately equal asset size used as comparators. FirstOntario actively participates in compensation surveys to ensure alignment with the market and employs third party compensation consultants to provide more independence to the process.

Executive compensation is reviewed and approved by the Board on an annual basis. As part of this review, the Board considers market expectations and projections of changes for comparable positions using, where available, independent, competent and relevant sources.

(c) Related party transactions:

FirstOntario's related parties include:

- (i) All members of the Board, Officers and Executives of FirstOntario.
- (ii) FirstOntario's subsidiaries (1320828 Ontario Limited, FOIH, FOIB) and joint ventures noted in Note 9.

FirstOntario Insurance Holdings Inc. is a wholly owned subsidiary of FirstOntario. FOIH is a holding company which manages FirstOntario's holdings in FirstOntario Insurance Brokerage Inc. FOIH holds 51% of the ownership interests and voting rights of FOIB. All intercompany transactions and balances have been eliminated.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

13. Regulatory Reporting and Disclosure (continued):

(c) Related party transactions (continued):

(ii) FOIB is an insurance brokerage which commenced operations during 2018. The remaining 49% of ownership interests and voting rights not held by FOIH are held by non-controlling interests. During the year, a net loss of \$65,000 was allocated to non-controlling interests, resulting in accumulated non-controlling interests of \$65,000 at December 31, 2018. All intercompany transactions and balances have been eliminated.

(iii) Defined benefit plans that are referred to in Note 18. FirstOntario's transactions with the plans include contributions paid into the plans. FirstOntario also pays for the expenses of the employee defined contribution plan. FirstOntario has not entered into other transactions with the defined benefit plans.

The following table outlines remuneration of members of the Board, Officers and Executives:

(In thousands of dollars)	2018	2017
Salaries, bonuses, and other short-term employee benefits	\$ 3,053	\$ 2,767
Post-employment benefits	201	200
Directors' remuneration	340	255
Total compensation	\$ 3,594	\$ 3,222

Related party balances as at December 31 are outlined in the following table:

(In thousands of dollars)	2018	2017
<u>Loans</u>		
Residential mortgages	\$ 2,883	\$ 2,984
Personal loans	128	81
Accrued interest	1	1
<u>Deposits and Shares</u>		
Deposits	2,129	1,624
Membership shares	3	3
Investment shares	413	397
Accrued interest	7	6

Total interest revenue derived from lending activity relating to key management personnel was \$90,000 during the year ended December 31, 2018 (2017 - \$84,000). Total interest expense from deposit-taking activity from related parties was \$25,000 during the year ended December 31, 2018 (2017 - \$28,000). During 2018 and 2017, no loans held by related parties were impaired.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

14. Loans Payable and Securitization Liabilities:

The following table details loans payable to Central 1 and other funding partners. Security pledged is set out in Note 21(c). All loans payable are classified as amortized cost (from January 1, 2018) and as other liabilities (before January 1, 2018).

(In thousands of dollars)	2018	2017
<u>Central 1 Credit Facilities</u>		
Term loan facilities, bearing a variable weighted average interest rate of nil% (2017 - 2.02%) due within one year	\$ -	\$ 50,000
<u>Caisse centrale Desjardins Credit Facilities</u>		
Term loan facility, bearing a fixed interest rate of 2.98% (2017 - 0%), maturity date of 2022	40,000	-
Term loan facility, bearing a variable interest rate of 2.25% + 0.50% (2017 - 0%), maturity date of 2020	50,000	-
<u>Securitization Liabilities</u>		
Mortgage Backed Securities secured by residential mortgage loans, bearing a weighted average fixed interest rate of 1.69% (2017 - 1.86%), expected weighted average maturity date of 2021 (2017 - 2023)	494,802	718,902
Mortgage Backed Securities secured by residential mortgage loans, bearing a weighted average variable interest rate of 2.79% (2017 - 1.92%), expected weighted average maturity date of 2019 (2017 - 2019)	23,286	33,480
	\$ 608,088	\$ 802,382

As at December 31, 2018 and December 31, 2017, FirstOntario was in compliance with all financial and non-financial covenants.

Interest expense associated with loans payable during the year consisted of the following:

(In thousands of dollars)	2018	2017
Term loans	\$ 3,032	\$ 2,080
Securitization of residential mortgages	12,819	17,037
	\$ 15,851	\$ 19,117

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

15. Derivative Financial Instruments:

(a) Asset liability management:

In the ordinary course of business, FirstOntario purchases derivative instruments from Central 1 and Concentra in order to hedge against exposure to interest rate fluctuations.

Derivative instruments have a fair value that varies based on the particular instrument and changes in interest rates. The purpose of these instruments is to provide a hedge against interest rate fluctuations by improving FirstOntario's matching of its asset and liability position.

(b) Product related:

FirstOntario offers deposit products linked to changes in equity indexes or specific bundles of equities. FirstOntario hedges the underlying risk of these products by entering into equity-linked purchase option contracts. Under the terms of these contracts, FirstOntario will receive payments approximate to the future payments to Members.

(c) Foreign exchange forward contracts:

FirstOntario offers deposit products denominated in US dollars. In order to meet liquidity reserve requirements FirstOntario sells US dollars and purchases US dollar foreign exchange forward contracts to hedge the exchange risk.

The following table summarizes the notional amounts, maturities and fair values of FirstOntario's derivative portfolio as at December 31, 2018 and December 31, 2017:

							2018
(In thousands of dollars)	Within 1 year	1 to 5 years	Over 5 years	Total	Fair Value		
					Assets	Liabilities	
Pay fixed interest rate swaps	\$ 80,000	\$ 56,622	\$ -	\$ 136,622	\$ 136	\$ 125	
Bond forwards	57,500	-	-	57,500	-	971	
Equity-linked options	1,337	1,832	-	3,169	96	30	
Foreign exchange forward contracts	34,691	2,664	-	37,355	211	69	
2018 Total	\$ 173,528	\$ 61,118	\$ -	\$ 234,646	\$ 443	\$ 1,195	
							2017
(In thousands of dollars)	Within 1 year	1 to 5 years	Over 5 years	Total	Fair Value		
					Assets	Liabilities	
Pay fixed interest rate swaps	\$ 10,000	\$ 86,680	\$ -	\$ 96,680	\$ 405	\$ 363	
Bond forwards	45,000	-	-	45,000	231	-	
Equity-linked options	688	2,901	-	3,589	287	183	
Foreign exchange forward contracts	14,650	-	-	14,650	460	783	
2017 Total	\$ 70,338	\$ 89,581	\$ -	\$ 159,919	\$ 1,383	\$ 1,329	

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

15. Derivative Financial Instruments (continued):

Notional amounts are the contract amounts used to calculate the cash flows to be exchanged. They are a common measure of the volume of outstanding transactions, but do not represent credit or market risk exposure. Notional amounts, other than foreign exchange forward contracts, are not exchanged.

FirstOntario is exposed to credit risk which arises from the possibility that a counterparty to a derivative contract could default on their obligation to FirstOntario. However, credit risk associated with derivative contracts is normally a small fraction of the notional principal amount of the contract. Derivative contracts expose FirstOntario to loss only if changes in market rates cause a material unfavourable effect on a counterparty's position, which could then lead to the counterparty defaulting on its payment. FirstOntario only enters into derivative contracts with counterparties that FirstOntario has determined to be creditworthy.

16. Financial Risk Management:

The Board of Directors (the "Board") has overall responsibility for the establishment and oversight of FirstOntario's risk management framework. The Board has delegated to the Audit and Risk Committee the responsibility for the development and monitoring of risk management policies. The Audit and Risk Committee reports regularly to the Board on its activities.

All risk management policies and established limits ensure that FirstOntario is in full adherence to the regulatory requirements prescribed in the Act as well as DICO's standards of Sound Business and Financial Practices. The Board receives reports from management on FirstOntario's exposure to credit, interest rate, liquidity, foreign currency and other price risk regularly in order to monitor financial risks.

(a) Credit Risk:

Credit risk is the potential for financial loss to FirstOntario if a borrower or guarantor fails to meet payment obligations in accordance with agreed terms. FirstOntario's financial assets that are affected by credit risk include loans receivable from Members, investments, and derivative financial instruments. Credit risk is one of the most significant financial risks to FirstOntario.

FirstOntario's primary objective when managing credit risk is to ensure a portfolio of high quality financial assets properly diversified so as to balance the risk associated with the portfolio and return on assets.

Credit risk is managed in accordance with the Credit Risk Management Policy for loans receivable from Members and the Market Risk Management Policy for investments and derivative financial instruments.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

16. Financial Risk Management (continued):

(a) Credit Risk (continued):

For loans receivable from Members, credit risk is managed through an infrastructure based upon:

- (i) Approval by the Board of all credit risk management policies;
- (ii) Approval by the Senior Vice President Credit of the discretionary limits of lending officers throughout FirstOntario;
- (iii) Credit adjudication subject to compliance with established policies, exposure guidelines and discretionary limits, as well as adherence to established standards of credit assessment. Credit approvals are escalated to the Management Credit Committee and ultimately to the Board of Directors dependent upon credit exposure level and restricted party transactions;
- (iv) The Credit Department is charged with oversight of the following:
 - a. The establishment of guidelines to monitor and limit concentrations in the portfolios in accordance with Board approved policies governing regulatory requirements, industry risk and group exposures;
 - b. The development and implementation of credit risk models and policies for establishing borrower risk ratings to quantify and monitor the level of risk and facilitate management of retail and commercial credit;
 - c. Implementation of an ongoing monitoring process of the key risk factors used in FirstOntario credit risk models.

Management has designed and implemented an effective system to measure, monitor and report credit risk exposure. Management reports credit risk exposure to the Board regularly.

In conducting lending activities, FirstOntario diversifies its portfolio of loans receivable from Members in order to reduce overall credit risk. Residential mortgage and personal loans are diversified between authorized loan types, forms of security and certain sectoral groupings.

Commercial loans are diversified through the establishment of credit exposure limits for specific industry sectors, groups of related borrowers and geographic location.

Credit exposure is assessed through the following:

- (i) Probability of default, which is an estimate of probability that a Member with a certain borrower risk rating, will default within a one year time horizon.
- (ii) Loss given default, which represents the unsecured portion expected to be lost when a borrower defaults.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

16. Financial Risk Management (continued):

(a) Credit Risk (continued):

Credit risk rating systems are designed to assess and quantify the risk inherent in credit activities in an accurate and consistent manner as follows:

- (i) Commercial loans are principally assessed based on factors including the Member's ability to service debt (debt service coverage ratio) and the secured amount (loan to value ratio). Management regularly reviews the commercial loan portfolio and assesses the credit risk associated with each loan.
- (ii) Automated credit scoring systems assist in assessing credit risk associated with residential mortgage and personal loans. These loans are managed as pools of homogeneous risk exposures using internal benchmarks based upon TransUnion Credit Vision and/or Equifax Beacon Scores. These global standard credit scores track each individual's past credit history and, using a mathematical model, predicts how likely a person is to repay a loan.

For investments and derivative financial instruments, risk is measured by reviewing exposure to individual counterparties to ensure the assets are within the policy limit by issuer weightings and by dollar amount. The quality of the counterparties is assessed through published credit rating agencies.

Except as noted, the carrying amount of financial assets recorded in the financial statements represents FirstOntario's maximum exposure to credit risk without taking into account the value of any collateral obtained. FirstOntario is also exposed to credit risk through transactions which are not recognized in the Consolidated Statement of Financial Position, such as granting financial guarantees and extending loan commitments. Refer to Note 21 for further details. The risk of losses from loans undertaken is reduced by the nature and quality of collateral obtained. Refer to Note 6 for a description of the nature of the security held against loans as at the date of the Consolidated Statement of Financial Position.

(b) Interest Rate Risk:

Interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. FirstOntario is exposed to interest rate risk when entering into banking transactions with Members, primarily deposit and lending activities.

FirstOntario's exposure to interest rate risk depends on the size and direction of interest rate changes, and on the size and maturity of mismatched positions. An interest-sensitive asset or liability is repriced when market interest rates change, when there is cash flow from final maturity, normal amortization, or when Members exercise prepayment, conversion or redemption options are offered for the specific product.

Interest rate risk is managed in accordance with the Structural Risk Management Policy. The Board delegates the responsibility to manage interest rate risk on a day-to-day basis to management.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

16. Financial Risk Management (continued):

(b) Interest Rate Risk (continued):

FirstOntario's Structural Risk Management Policy includes:

- (i) Guidelines and limits on the structuring of the maturities, price and mix of deposits, loans, mortgages and investments and the management of cash flows derived from financial assets in relation to liabilities.
- (ii) Guidelines and limits on the use of derivative products to hedge against changes in cash flows as a result of changes in interest rates.

The following table summarizes carrying amounts of Consolidated Statement of Financial Position assets, liabilities and equity, and derivative instruments to arrive at FirstOntario's interest rate gap based on the earlier of contractual repricing and maturity dates:

	2018					
(In thousands of dollars)	Within 3 months	3 Months to 1 year	1 to 5 years	Over 5 years	Non Interest Sensitive	Total
Assets						
Loans receivable	\$ 539,615	\$ 760,980	\$ 2,275,081	\$ 13,576	\$ -	\$ 3,589,252
Cash	-	-	-	-	62,317	62,317
Investments	11,186	44,441	211,757	-	228,469	495,853
Other	254	82	107	-	64,972	65,415
	\$ 551,055	\$ 805,503	\$ 2,486,945	\$ 13,576	\$ 355,758	\$ 4,212,837
Liabilities and equity						
Deposits	\$ 1,064,384	\$ 953,674	\$ 781,409	\$ 121	\$ 489,650	\$ 3,289,238
Loans	110,155	115,712	382,221	-	-	608,088
Other	1,019	85	91	-	314,316	315,511
	\$ 1,175,558	\$ 1,069,471	\$ 1,163,721	\$ 121	\$ 803,966	\$ 4,212,837
Gap-Financial position	(624,503)	(263,968)	1,323,224	13,455	(448,208)	-
Gap-Derivatives	(44,122)	45,000	(878)	-	-	-
Interest rate gap 2018	\$ (668,625)	\$ (218,968)	\$ 1,322,346	\$ 13,455	\$ (448,208)	\$ -

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

16. Financial Risk Management (continued):

(b) Interest Rate Risk (continued):

	2017					
(In thousands of dollars)	Within 3 months	3 Months to 1 year	1 to 5 years	Over 5 years	Non Interest Sensitive	Total
Assets						
Loans receivable	\$ 792,949	\$ 453,619	\$ 2,100,255	\$ 27,654	\$ -	\$3,374,477
Cash	-	-	-	-	43,098	43,098
Investments	5,677	27,224	205,632	-	169,763	408,296
Other	712	88	583	-	63,018	64,401
	\$ 799,338	\$ 480,931	\$ 2,306,470	\$ 27,654	\$ 275,879	\$3,890,272
Liabilities and equity						
Deposits	\$ 1,395,040	\$ 508,522	\$ 436,753	\$ 124	\$ 443,907	\$2,784,346
Loans	51,715	274,475	476,192	-	-	802,382
Other	798	110	422	-	302,214	303,544
	\$ 1,447,553	\$ 783,107	\$ 913,367	\$ 124	\$ 746,121	\$3,890,272
Gap-Financial position	(648,215)	(302,176)	1,393,103	27,530	(470,242)	-
Gap-Derivatives	141,680	(10,030)	(131,650)	-	-	-
Interest rate gap 2017	\$ (506,535)	\$ (312,206)	\$ 1,261,453	\$ 27,530	\$ (470,242)	\$ -

Key metrics involved in management of interest rate risk include the use of Earnings at Risk ("EaR") and Economic Value of Equity at Risk ("EVEaR"). EaR is defined as the change in the net interest income from a 100 basis point ("bps") shock to interest rates. This exposure is measured over a 12 month period. EVEaR is defined as the difference in the change in the present value of the asset portfolio and the change in the present value of the liability portfolio, including off-Statement of Financial Position instruments, resulting from a 100 bps interest rate shock.

The following table summarizes the EaR and EVEaR as follows:

(In thousands of dollars)	2018	2017
EaR - Up 100 bps	\$ 230	\$ 1,996
EaR - Down 100 bps	(625)	(785)
EVEaR - Up 100 bps	(1.96)%	(1.00)%
EVEaR - Down 100 bps	1.63 %	1.00 %

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

16. Financial Risk Management (continued):

(b) Interest Rate Risk (continued):

Fair Value Hedges

FirstOntario had designated hedging relationships involving bond forwards that hedged mortgage assets that were associated with debt issuances relating to securitization activity as fair value hedges. Realized gains (losses) on these derivatives were deferred and amortized in accordance with the effective interest rate method along with the asset originated. During the year, income of \$nil (2017 - \$nil) due to hedge ineffectiveness arose and was recorded in other interest income in the Consolidated Statement of Income. Fair values of the bond forwards involved in these hedges that were unrealized at the end of the year was \$nil (2017 - \$nil). The amount of deferred gain that is expected to be reclassified to the Consolidated Statement of Income over the next 12 months is \$209,000 (2017 - \$307,000).

Cash Flow Hedges

FirstOntario had designated certain hedging relationships involving interest rate swaps that converted variable rate deposits to fixed rate deposits as cash flow hedges. During the year ended December 31, 2018 amortization of other comprehensive gain of \$646,000 (2017 - \$646,000) was recorded in other interest expense in the Consolidated Statement of Income. The fair value of interest rate swaps involved in hedging relationships at the end of the year was \$nil (2017 - \$nil). The amount of other comprehensive gain that is expected to be reclassified to the Consolidated Statement of Income over the next 12 months is \$341,000 (2017 - \$629,000).

FirstOntario has also designated hedging relationships involving bond forwards that hedged forecasted debt issuances associated with securitization activity as cash flow hedges. Realized gains (losses) on these derivatives are deferred and amortized in accordance with the effective interest rate method along with the debt originated. The fair value of bond forwards involved in these hedges at the end of the year was a liability of \$971,000 (2017 - \$nil). The amount of other comprehensive gain that is expected to be reclassified to the Consolidated Statement of Income over the next 12 months is \$164,000 (2017 - \$206,000).

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

16. Financial Risk Management (continued):

(c) Liquidity Risk:

Liquidity risk is the risk that FirstOntario will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or other financial assets.

FirstOntario engages in proper liquidity risk management practices to comply with regulatory requirements and to guarantee the funding of Member needs and obligations. FirstOntario's overall objective when managing liquidity is to ensure limited exposure to material liquidity risk.

Liquidity risk is managed in accordance with the Liquidity Risk Management Policy. Key elements of this policy include limits on the sources, quality and amount of liquid assets to meet operational requirements, regulatory requirements and contingency funding. Liquidity is monitored by management through FirstOntario's Asset/Liability Committee ("ALCO"), consisting of the executive.

Under the Regulations, FirstOntario must establish and maintain prudent levels of liquidity that are sufficient to meet its cash flow needs, including depositor withdrawals and all other obligations as they come due. FirstOntario targets to maintain operating liquidity within the range of 8% to 16%. The low end of the range has been established in order to maintain a comfortable cushion beyond the minimum policy requirements in order to meet cash needs, even during periods of market volatility. As at December 31, 2018, FirstOntario's liquidity ratio was 11.32% (2017 - 11.16%) and assets held for liquidity purposes totaled \$394,936,000 (2017 - \$316,184,000), consisting of \$254,942,000 (2017 - \$238,533,000) liquidity reserve deposits, \$77,677,000 (2017 - \$34,553,000) National Housing Act mortgage-backed securities held for liquidity and \$62,317,000 (2017 - \$43,098,000) cash.

The following tables demonstrate FirstOntario's ability to pay future obligations as financial assets and liabilities mature as at December 31, 2018 and 2017. These cash flows include both the contractual cash flows currently exposed on the Consolidated Statement of Financial Position and the cash flows that will be generated in the future. In the case of loans, the cash flows include estimated prepayments and credit losses based on experience and current economic conditions.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

16. Financial Risk Management (continued):

(c) Liquidity Risk (continued):

							2018
(In thousands of dollars)	Within 1 month	2 to 12 months	1 to 3 years	3 to 5 years	Over 5 years	Not Specified	Total
Assets							
Loans receivable							
from Members	\$ 483,585	\$ 1,050,300	\$ 1,467,497	\$ 811,463	\$ 15,896	\$ -	\$ 3,828,741
Cash	62,317	-	-	-	-	-	62,317
Investments	3,662	55,680	112,169	110,017	-	226,806	508,334
Derivative financial instruments	93	243	106	1	-	-	443
Total cash inflow	\$ 549,657	\$ 1,106,223	\$ 1,579,772	\$ 921,481	\$ 15,896	\$ 226,806	\$ 4,399,835
Liabilities							
Members' deposits and shares	\$ 1,341,210	\$ 1,204,832	\$ 638,069	\$ 203,452	\$ 144	\$ 128,572	\$ 3,516,279
Loans payable	14,934	166,489	342,220	128,748	-	-	652,391
Other liabilities	46,647	-	-	-	-	-	46,647
Derivative financial instruments	68	1,036	78	13	-	-	1,195
Total cash outflow	\$ 1,402,859	\$ 1,372,357	\$ 980,367	\$ 332,213	\$ 144	\$ 128,572	\$ 4,216,512
							2017
(In thousands of dollars)	Within 1 month	2 to 12 months	1 to 3 years	3 to 5 years	Over 5 years	Not Specified	Total
Assets							
Loans receivable							
from Members	\$ 379,611	\$ 951,850	\$ 1,301,938	\$ 906,838	\$ 48,527	\$ 7,531	\$ 3,596,295
Cash	43,098	-	-	-	-	-	43,098
Investments	1,967	36,050	102,212	110,113	-	164,290	414,632
Derivative financial instruments	56	744	495	88	-	-	1,383
Total cash inflow	\$ 424,732	\$ 988,644	\$ 1,404,645	\$ 1,017,039	\$ 48,527	\$ 171,821	\$ 4,055,408
Liabilities							
Members' deposits and shares	\$ 1,202,822	\$ 1,166,243	\$ 354,874	\$ 101,110	\$ 124	\$ (67)	\$ 2,825,106
Loans payable	1,957	313,221	315,640	207,529	-	-	838,347
Other liabilities	49,660	-	-	-	-	-	49,660
Derivative financial instruments	148	760	300	121	-	-	1,329
Total cash outflow	\$ 1,254,587	\$ 1,480,224	\$ 670,814	\$ 308,760	\$ 124	\$ (67)	\$ 3,714,442

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

16. Financial Risk Management (continued):

(d) Foreign Currency Risk:

Currency risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate due to changes in foreign exchange rates. FirstOntario is exposed to foreign currency risk as a result of its Members' activities in US dollar currency denominated deposits and cash transactions, as well as US dollar investments. Activities that expose FirstOntario to currency risk are measured, monitored and controlled daily to minimize risk. At any point in time, net US dollar exposure is limited by the Market Risk Management Policy to \$500,000 through the use of foreign exchange forward contracts. As at December 31, 2018, FirstOntario does not have significant exposure to changes in foreign currency exchange rates.

(e) Equity and Other Price Risk:

Other price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices other than those arising from interest rate risk or currency risk. FirstOntario is primarily exposed to other price risk through actively traded fair value investments. However, these investments are limited by policy to ensure diversification and quality of financial assets. As at December 31, 2018, had the value of FirstOntario's managed funds, preferred, common and CUCO shares increased or decreased by 10% with all other variables remaining unchanged, the portfolio's asset value would have increased or decreased respectively by \$7,897,000 (2017 - \$2,731,000) or 3.5% (2017 - 1.3%) of total Members' Equity.

17. Fair Values of Financial Instruments:

The following table represents the fair values of FirstOntario's financial instruments. The fair values disclosed do not include the value of assets that are not considered financial instruments, such as fixed assets. The value of intangibles such as long-term Member relationships are also not included in the fair value amounts.

While the fair value amounts are intended to represent estimates of the amounts at which these instruments could be exchanged in a current transaction between willing parties, some of FirstOntario's financial instruments lack an available trading market. Consequently, the fair values presented are estimates derived using present value and other valuations techniques and may not be indicative of the net realizable values.

Due to the judgment used in applying a wide range of acceptable valuation techniques and estimates in calculating fair value amounts, fair values are not necessarily comparable among financial institutions. The calculation of estimated fair values is based on market conditions at a specific point in time and may not be reflective of future fair values.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

17. Fair Values of Financial Instruments (continued):

(In thousands of dollars)	FVTPL- Mandatorily	FVOCI- Equity Instruments	Amortized Cost	Total Carrying Value	2018 Fair Value
Financial Assets					
Cash and cash equivalents	\$ -	\$ -	\$ 62,317	\$ 62,317	\$ 62,317
Investments	120,347	20,317	267,384	408,048	405,533
Loans receivable from Members	-	-	3,609,006	3,609,006	3,591,045
Derivatives	443	-	-	443	443
Total financial assets	\$ 120,790	\$ 20,317	\$ 3,938,707	\$ 4,079,814	\$ 4,059,338
Financial Liabilities					
Members' deposits and shares	\$ -	\$ -	\$ 3,332,404	\$ 3,332,404	\$ 3,328,558
Loans payable	-	-	608,088	608,088	600,588
Accounts payable and accrued liabilities	-	-	45,573	45,573	45,573
Derivatives	1,195	-	-	1,195	1,195
Total financial liabilities	\$ 1,195	\$ -	\$ 3,986,065	\$ 3,987,260	\$ 3,975,914

(In thousands of dollars)	FVTPL	Held-to- Maturity	Loans and Receivables	Available-for- Sale	Other Amortized Cost	Total Carrying Value	2017 Fair Value
Financial Assets							
Cash and cash equivalents	\$ 43,098	\$ -	\$ -	\$ -	\$ -	\$ 43,098	\$ 43,098
Investments	25,238	240,181	5,658	62,146	-	333,223	330,332
Loans receivable from Members	-	-	3,393,395	-	-	3,393,395	3,390,788
Derivatives	1,383	-	-	-	-	1,383	1,383
Total financial assets	\$ 69,719	\$ 240,181	\$ 3,399,053	\$ 62,146	\$ -	\$ 3,771,099	\$ 3,765,601
Financial Liabilities							
Members' deposits and shares	\$ -	\$ -	\$ -	\$ -	\$ 2,820,396	\$ 2,820,396	\$ 2,829,511
Loans payable	-	-	-	-	802,382	802,382	799,741
Accounts payable and accrued liabilities	-	-	-	-	49,660	49,660	49,660
Derivatives	1,329	-	-	-	-	1,329	1,329
Total financial liabilities	\$ 1,329	\$ -	\$ -	\$ -	\$ 3,672,438	\$ 3,673,767	\$ 3,680,241

Interest rate sensitivity is the main cause of change in fair values of FirstOntario's financial instruments.

The following methods and assumptions were used to estimate the fair value of financial instruments:

- The fair values of cash and accounts payable and accrued liabilities are assumed to approximate their book values, due to their short-term nature.
- The estimated fair value of floating rate loans, demand deposits and floating rate deposits are assumed to be equal to book value as the interest rates on these loans and deposits reprice to market on a periodic basis.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

17. Fair Values of Financial Instruments (continued):

- (c) The estimated fair values of fixed rate investments, fixed rate loans and fixed rate deposits are determined by discounting the expected future cash flows of these investments, loans, deposits and borrowings at current market rates for products with similar terms and credit risks.
- (d) The estimated fair values of derivative instruments are determined through valuation models on the derivative notional amounts, maturity dates and rates.
- (e) The estimated fair values of investments in publicly listed equity securities are determined using quoted market prices.

Fair value measurements can be classified in a hierarchy in order to discern the significance of management assumptions and other inputs incorporated into the measurements. The three levels of fair value hierarchy are:

Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2 – Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data.

Level 3 – Inputs for the asset or liability that are not based on observable market data. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments are required to reflect differences between the instruments.

The following table summarizes the classification of FirstOntario's financial instruments held and reported on the Consolidated Statement of Financial Position at fair value:

	2018			
(In thousands of dollars)	Level 1	Level 2	Level 3	Total
Assets				
Investments – FVTPL	\$ 76,860	\$ 37,767	\$ 5,750	\$ 120,377
Investments – FVOCI	9	-	20,308	20,317
Derivative financial instruments	-	443	-	443
Total assets held at fair value	\$ 76,869	\$ 38,210	\$ 26,058	\$ 141,137
Liabilities				
Derivative financial instruments	\$ -	\$ 1,195	\$ -	\$ 1,195
Total liabilities held at fair value	\$ -	\$ 1,195	\$ -	\$ 1,195

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

17. Fair Values of Financial Instruments (continued):

	2017			
(In thousands of dollars)	Level 1	Level 2	Level 3	Total
Assets				
Investments – FVTPL securities	\$ 25,151	\$ 87	\$ -	\$ 25,238
Investments – Marketable equity securities	2,073	-	-	2,073
Investments – Retained rights – loan securitizations	-	39,548	-	39,548
Derivative financial instruments	-	1,383	-	1,383
Total assets held at fair value	\$ 27,224	\$ 41,018	\$ -	\$ 68,242
Liabilities				
Derivative financial instruments	\$ -	\$ 1,329	\$ -	\$ 1,329
Total liabilities held at fair value	\$ -	\$ 1,329	\$ -	\$ 1,329

The following table summarizes the Level 2 fair values of FirstOntario's financial instruments whose carrying value are not fair value on the Consolidated Statement of Financial Position as at December 31, 2018 and December 31, 2017. Financial assets and liabilities whose carrying values are a reasonable approximation of fair value are not included. FirstOntario's financial instruments held at amortized cost are all classified as Level 2 as identified below:

(In thousands of dollars)	2018	2017
Assets		
Loans receivable	\$ 3,589,267	\$ 3,390,788
Investments	264,839	242,948
Total assets held at fair value	\$ 3,854,106	\$ 3,633,736
Liabilities		
Deposits and shares	\$ 3,328,558	\$ 2,829,511
Loans payable	600,588	799,741
Total liabilities held at fair value	\$ 3,929,146	\$ 3,629,252

The fair value measurement of all of the joint ventures has been categorized as a level 3 fair value based on the inputs of the valuation technique used (See Note 9).

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

18. Employee Retirement Benefits:

FirstOntario provides retirement benefits to certain employees. These benefits include registered pension plans, medical benefits, dental care and life insurance.

The fair value of accrued benefit obligations were determined by independent actuaries as at December 31, 2018 and December 31, 2017.

(In thousands of dollars)	Defined Benefit Pensions		Other Defined Benefit Plans	
	2018	2017	2018	2017
Accrued benefit obligation				
Balance at the beginning of year	\$ 18,768	\$ 16,952	\$ 5,516	\$ 5,250
Current service cost	542	477	45	42
Interest cost	639	661	184	200
Benefits paid	(999)	(1,006)	(133)	(168)
Actuarial (gain) loss	(1,497)	1,684	(521)	192
Balance at end of year	\$ 17,453	\$ 18,768	\$ 5,091	\$ 5,516
Plan assets				
Fair value at beginning of year	\$ 16,066	\$ 15,407	\$ -	\$ -
Expected return on plan assets	534	593	-	-
Actuarial (loss) gain on plan assets	(390)	463	-	-
Employer contributions	319	609	133	168
Benefits paid	(999)	(1,006)	(133)	(168)
Fair value at end of year	15,530	16,066	-	-
Balance at end of year	\$ (1,923)	\$ (2,702)	\$ (5,091)	\$ (5,516)

The following table provides the amounts recognized in the Consolidated Statement of Financial Position as follows:

(In thousands of dollars)	Defined Benefit Pensions		Other Defined Benefit Plans	
	2018	2017	2018	2017
Accrued benefit liabilities recorded in				
other liabilities	\$ (1,923)	\$ (2,702)	\$ (5,091)	\$ (5,516)
Balance at end of year	\$ (1,923)	\$ (2,702)	\$ (5,091)	\$ (5,516)

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

18. Employee Retirement Benefits (continued):

FirstOntario's net benefit plan expenses recognized in other comprehensive income were as follows:

(In thousands of dollars)	Defined Benefit Pensions		Other Defined Benefit Plans	
	2018	2017	2018	2017
Cumulative actuarial losses at beginning of year	\$ (3,992)	\$ (2,771)	\$ 402	\$ 594
Actuarial gain (loss) in the year on liability	1,497	(1,684)	521	(192)
Actuarial gain (loss) in the year on plan assets	(390)	463	-	-
Cumulative actuarial gain (loss)	\$ (2,885)	\$ (3,992)	\$ 923	\$ 402

The net gain recognized in other comprehensive income of \$1,228,000 (2017 - loss of \$1,127,000) during the year are net of a tax expense of \$400,000 (2017 - tax recovery of \$286,000) as disclosed in Note 20.

FirstOntario's net benefit plan expenses recognized in the Consolidated Statement of Income were as follows:

(In thousands of dollars)	Defined Benefit Pensions		Other Defined Benefit Plans	
	2018	2017	2018	2017
Current service cost	\$ 542	\$ 477	\$ 45	\$ 42
Interest cost	639	661	184	200
Expected return on plan assets	(534)	(593)	-	-
Total included in employee benefits expense	\$ 647	\$ 545	\$ 229	\$ 242

(In thousands of dollars)	Defined Contribution Pension	
	2018	2017
Contributions recorded as expenses	\$ 1,838	\$ 1,629

These net benefit plan and contribution expenses are included in salaries and employee benefits on the Consolidated Statement of Income. Aggregate contributions relating to defined benefit pensions and other defined benefit plans expected for the year ended December 31, 2019, is \$683,000.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

18. Employee Retirement Benefits (continued):

The significant actuarial assumptions adopted by FirstOntario are as follows (weighted-average assumptions):

(In thousands of dollars)	Defined Benefit Pensions		Other Defined Benefit Plans	
	2018	2017	2018	2017
Discount rate	3.9%	3.4%	3.9%	3.4%
Rate of compensation increase	2.0%	2.0%	-	-

The expected rate of return on plan assets is based on the risks and associated returns expected of the underlying plan assets. Plan assets are held in balanced funds which includes equities and long-term bonds.

For measurement purposes, 5% and 3% rates of increase in the per capita cost of covered health care and dental care benefits respectively were assumed for 2018. The rate of increase for health care benefits was assumed to remain unchanged at 5%. The rate of increase for dental care benefits was assumed to remain unchanged at 3%.

A one percentage-point change in assumed health-care cost trend rates, discount rates and salary costs would have the following impact on other defined benefit plans:

(In thousands of dollars)	2018		2017	
	Defined benefit	Other plans	Defined benefit	Other plans
Health care				
1% increase	\$ na	\$ 379	\$ na	\$ 550
1% decrease	na	(328)	na	(473)
Discount rate				
1% increase	\$ (2,616)	\$ (518)	\$ (2,958)	\$ (600)
1% decrease	3,082	577	3,517	674
Salary rate				
1% increase	\$ 144	\$ na	\$ 190	\$ na
1% decrease	(140)	na	(184)	na

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

19. Other Income:

(In thousands of dollars)	2018	2017
Service charges	\$ 3,394	\$ 2,867
Mortgage and loan fees	3,662	4,027
Commissions	2,006	2,208
Other operational income	760	1,037
Wealth management	2,458	2,165
Securitization	6,120	7,496
Real estate	6,952	4,331
Other investment income	6,066	2,436
Total other income	\$ 31,418	\$ 26,567

20. Income Taxes:

The components of income tax expense (benefit) are as follows:

(In thousands of dollars)	2018	2017
Current income tax expense	\$ (1,027)	\$ 217
Deferred income tax expense	2,366	3,217
Total income tax expense	\$ 1,339	\$ 3,434

Major components of income tax expense (benefit) include the following:

	2018	2017
Combined federal and provincial income taxes	26.5%	26.5%
Small business and credit union deductions	(8.0)	(6.3)
Income and expense permanent differences	0.5	0.3
Tax rate change	(4.7)	0.1
Other	(0.2)	0.0
Total income tax expense	14.1%	20.6%

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

20. Income Taxes (continued):

The movements of deferred tax assets and liabilities are presented below:

(In thousands of dollars)	January 1, 2018	Charge to Income	Charge to OCI	December 31, 2018
Fixed assets	\$ (2,218)	\$ (1,179)	\$ -	\$ (3,397)
Allowance for loan losses	1,275	(465)	-	810
Derivatives	103	118	-	221
Employee retirement benefits	1,668	21	(400)	1,289
Investments	(4,035)	(558)	-	(4,593)
Cash flow hedges	269	(23)	78	324
Other	(702)	(280)	-	(982)
Total	\$ (3,640)	\$ (2,366)	\$ (322)	\$ (6,328)

(In thousands of dollars)	January 1, 2017	Charge to Income	Charge to OCI	December 31, 2017
Fixed assets	\$ (799)	\$ (1,419)	\$ -	\$ (2,218)
Allowance for loan losses	1,246	29	-	1,275
Derivatives	95	8	-	103
Employee retirement benefits	1,462	(80)	286	1,668
Investments	(2,859)	(1,181)	5	(4,035)
Cash flow hedges	487	90	(308)	269
Other	(38)	(664)	-	(702)
Total	\$ (406)	\$ (3,217)	\$ (17)	\$ (3,640)

The tax effect of items recorded in the Consolidated Statement of Other Comprehensive Income was as follows:

(In thousands of dollars)	2018	2017
Net loss on cash flow hedges	\$ 236	\$ -
Net gain on cash flow hedges transferred to earnings	(158)	(308)
Net change in fair value of available-for-sale investments	-	5
Actuarial (gain) loss on defined benefit pension plans	(400)	286
Total tax effect of components of other comprehensive income	\$ (322)	\$ (17)

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

21. Commitments:

(a) Leases:

FirstOntario leases space for most of its branches and some computer equipment. The leases have varying terms, escalation clauses and renewal rights. Lease payments made as a result of operating leases during the year were \$4,193,000 (2017 - \$3,925,000). Total future minimum lease payments under non-cancellable operating leases are as follows:

(In thousands of dollars)	2018	2017
Within 1 year	\$ 4,054	\$ 3,866
1 to 5 years	9,108	10,499
Over 5 years	1,588	3,057

(b) Mortgage commitments and lines of credit:

At December 31, 2018, FirstOntario has issued commitments to provide residential mortgage and commercial loans totaling \$244,526,000 (2017 - \$186,769,000). FirstOntario has also provided lines of credit to Members totaling \$826,668,000 at December 31, 2018 (2017 - \$791,657,000), against which Members have drawn \$392,862,000 (2017 - \$369,744,000).

(c) Credit facilities:

Central 1 has provided an operating loan facility to FirstOntario of \$164,000,000 (2017 - \$164,000,000). Loans to Members have been pledged as security for these facilities and the term loan by an assignment of book debts and a general security agreement.

Caisse centrale Desjardins has provided an operating facility to FirstOntario in the amount of \$100,000,000 (2017 - \$100,000,000). When amounts are drawn against the facility, certain residential mortgages have been pledged as security.

See the Consolidated Statement of Financial Position and Note 14 for the outstanding amounts on these facilities.

(d) Contracts:

Interac ATM and point of sale switching servicing totaling \$3,803,000 over the next 5 years at present service levels (2017 - \$1,335,000 over the next 2 years).

Banking system support services and software maintenance totaling \$7,087,000 over the next 13 years (2017 - \$4,628,000 over the next 14 years).

Telephone network and voice services totaling \$936,000 over the next 2 years at present service levels (2017 - \$2,031,000 over the next 3 years).

Sponsorship agreement totaling \$1,492,000 over the next 3 years (2017 - \$1,970,000 over the next 4 years).

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

21. Commitments (continued):

(e) Naming rights:

In fiscal 2017, FirstOntario entered into an agreement with Global Spectrum Facility Management, L.P. for the naming rights to the FirstOntario Concert Hall. The agreement is effective January 1, 2017 and provides the naming rights for 10 years at an estimated cost of \$283,000 per year for an aggregate total of \$2,830,000.

In fiscal 2017, FirstOntario entered into an agreement with The Corporation of the Town of Milton for the naming rights to the FirstOntario Centre for the Arts. The agreement is effective January 24, 2017 and provides the naming rights for 25 years at an estimated cost of \$226,000 per year for the first five years for an aggregate total of \$1,130,000.

In fiscal 2015, FirstOntario entered into an agreement with The Corporation of the City of St. Catharines, for the naming rights to the FirstOntario Performing Arts Centre. The agreement is effective January 1, 2016 and provides the naming rights for 25 years at an estimated cost of \$678,000 per year for the first five years for an aggregate total of \$3,390,000.

In fiscal 2014, FirstOntario entered into an agreement with Global Spectrum, L.P. for the naming rights to the FirstOntario Centre. The agreement provides the naming rights for 10 years at an estimated cost of \$396,000 per year for an aggregate total of \$3,955,000.

22. Change in Accounting Policies:

Except for the changes below, FirstOntario has consistently applied the accounting policies as set out in Note 3 to all periods presented in these consolidated financial statements.

(a) IFRS 9 Financial Instruments:

FirstOntario has adopted IFRS 9 *Financial Instruments* issued in July 2014 with a date of initial application of January 1, 2018. The requirements of IFRS 9 represent a significant change from IAS 39 *Financial Instruments: Recognition and Measurement*. The new standard brings fundamental changes to the accounting for financial assets and to certain aspects of the accounting for financial liabilities.

As permitted by IFRS 9, FirstOntario has elected to continue to apply the hedge accounting requirements of IAS 39.

The key changes to FirstOntario's accounting policies resulting from its adoption of IFRS 9 are summarized below.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

22. Change in Accounting Policies (continued):

(a) IFRS 9 Financial Instruments (continued):

IFRS 9 contains three principal classification categories for financial assets: measured at amortized cost, fair value through other comprehensive income (“FVOCI”) and fair value through profit or loss (“FVTPL”). IFRS 9 classification is generally based on the business model in which a financial asset is managed and its contractual cash flows. The standard eliminates the existing IAS 39 categories of held-to-maturity, loans and receivables and available-for-sale. Classification of financial assets under IFRS 9 is outlined in Note 3.

IFRS 9 largely retains the existing requirements in IAS 39 for the classification of financial liabilities.

IFRS 9 replaces the “incurred loss” model in IAS 39 with an “expected credit loss” model. The new impairment model also applies to certain loan commitments and financial guarantee contracts but not to equity investments. Under IFRS 9, credit losses are recognized earlier than under IAS 39. The impairment requirements of IFRS 9 are outlined in Note 3.

Comparative periods have not been restated. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 are recognized in retained earnings as at January 1, 2018. Accordingly, the information presented for 2017 does not reflect the requirements of IFRS 9 and therefore is not comparable to the information presented for 2018 under IFRS 9.

The following assessments have been made on the basis of the facts and circumstances that existed at the date of initial application:

- the determination of the business model within which a financial asset is held;
- the designation and revocation of previous designations of certain financial assets and financial liabilities as measured at FVTPL;
- the designation of certain investments in equity instruments not held for trading as at FVOCI.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

22. Change in Accounting Policies (continued):

(a) IFRS 9 Financial Instruments (continued):

(i) Reconciliation of IAS 39 to IFRS 9

On adoption of IFRS 9, FirstOntario has assessed all of its financial instruments based on the business model and solely payments of principal and interest (“SPPI”) tests. This has resulted in the reclassification and re-measurement of certain financial assets and financial liabilities as at January 1, 2018, which are summarized in the table below:

(In thousands of dollars)	As at December 31, 2017				As at January 1, 2018			
	Measurement Basis	IAS 39 Carrying Amount	Re-classification	Re-measurement ^(c)	Measurement Basis	IFRS 9 Carrying Amount		
Financial Assets								
Cash and cash equivalents	FVTPL	\$ 43,098	\$ -	\$ -	Am Cost	\$ 43,098		
<i>Investments:</i>								
Liquidity reserve deposits	Am Cost	240,181	-	-	Am Cost	240,181		
Preferred shares	FVTPL	2,073	-	-	FVOCI	2,073		
CUCO Co-Operative Association	FVTPL	87	-	-	FVTPL	87		
Managed funds	FVTPL	25,151	-	-	FVTPL	25,151		
Shares – Central 1	Cost	19,275	-	-	FVOCI	19,275		
Shares – other	Cost	1,250	-	-	FVTPL	1,250		
Retained rights - loan securitizations	FVTPL	39,548	-	-	FVTPL	39,548		
Investment in loans	Am Cost	5,658	-	-	Am Cost	5,658		
Loans receivable from Members	Am Cost	3,393,395	(115,290)	-	Am Cost	3,278,105		
Loans receivable from Members ^(a)	FVTPL	-	115,290	(160)	FVTPL	115,130		
Derivatives	FVTPL	1,383	-	-	FVTPL	1,383		
		\$ 3,771,099	\$ -	\$ (160)		\$ 3,770,939		
Financial Liabilities								
Members' deposits	Am Cost	\$ 2,798,078	\$ -	\$ -	Am Cost	\$ 2,798,078		
Membership shares	Am Cost	9,110	-	-	Am Cost	9,110		
Investment shares	Am Cost	13,208	-	-	Am Cost	13,208		
Loans payable	Am Cost	50,000	-	-	Am Cost	50,000		
Securitization liabilities	Am Cost	752,382	(100,236)	-	Am Cost	652,146		
Securitization liabilities ^(b)		-	100,236	623	FVTPL	100,859		
Accounts payable and accrued liabilities	Am Cost	49,660	-	-	Am Cost	49,660		
Derivatives	FVTPL	1,329	-	-	FVTPL	1,329		
		\$ 3,673,767	\$ -	\$ 623		\$ 3,674,390		

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

22. Change in Accounting Policies (continued):

(a) IFRS 9 Financial Instruments (continued):

(i) Reconciliation of IAS 39 to IFRS 9 (continued)

- (a) Certain residential mortgages were originated with the specific intention of being securitized as part of portfolios that meet the derecognition requirements under IFRS 9. The business model objective for such portfolios is not to hold the mortgages to collect contractual cash flows. As such, under IFRS 9 the mortgages are classified as mandatorily measured at FVTPL. Before the adoption of IFRS 9, these mortgages were classified as loans and receivables and measured at amortized cost. Transaction costs attributable to the acquisition of the residential mortgages reclassified to FVTPL (see (a) above) are recognized as incurred. Before the adoption of IFRS 9, costs relating to these mortgages were capitalized and amortized over the expected life of the mortgage.
- (b) Securitization liabilities relating to the residential mortgages reclassified to FVTPL (see (a) above) are designated as FVTPL. Before the adoption of IFRS 9, these securitization liabilities were classified as other liabilities and measured at amortized cost. Transaction costs attributable to the issuance of the securitization liabilities measured at FVTPL are recognized as incurred. Before the adoption of IFRS 9, costs relating to these securitization liabilities were capitalized and amortized over the expected life of the securitization liabilities.
- (c) As at January 1, 2018, the adoption of IFRS 9 related to classification and measurement changes has decreased loans receivable from Members by \$160,000, increased securitization liabilities by \$623,000, and increased the opening Members' equity by \$368,000, net of tax.

(ii) Reconciliation of impairment allowance balance from IAS 39 to IFRS 9:

The following table reconciles the closing allowance for credit losses in accordance with IAS 39 as at December 31, 2017 to the opening ECL allowance in accordance with IFRS 9 as at January 1, 2018:

	As at December 31, 2017			Transition adjustments ^(a)	As at January 1, 2018			
	IAS 39		Total		IFRS 9			Stage 3
(In thousands of dollars)	Specific	Collective	Total	Total	Stage 1	Stage 2	Stage 3	
Loans receivable from Members	\$ 1,406	\$ 6,079	\$ 7,485	\$ (473)	\$ 7,012	\$ 2,604	\$ 2,327	\$ 2,081

- (a) As at January 1, 2018, the adoption of IFRS 9 has decreased the allowance for credit losses by \$473,000, and increased the opening Members' equity by \$376,000, net of tax.

FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended December 31, 2018

22. Change in Accounting Policies (continued):

(iii) Summary of IFRS 9 adjustments to January 1 2018 retained earnings:

(In thousands of dollars)	January 1, 2018
Classification and measurement adjustment ^(a)	\$ 368
Impairment allowance adjustment ^(b)	376
Total adjustment to January 1, 2018 retained earnings	\$ 744

(a) Refer to Note 22(a)(i) for details.

(b) Refer to Note 22(a)(ii) for details.

(b) IFRS 15 Revenue from Contracts with Customers:

On January 1, 2018, FirstOntario adopted IFRS 15 *Revenue from Contracts with Customers* which replaced the revenue recognition guidance from IAS 18 *Revenue*, IAS 11 *Construction Contracts*, and related interpretations. The new standard provides a single, principles-based five-step model to be applied to all sales contracts, based on the transfer of control of goods and services to customers. As such, FirstOntario has changed its accounting policies for revenue recognition as detailed in Note 3(l). The adoption of IFRS 15 did not have a material impact on FirstOntario's financial statements as the majority of FirstOntario's revenue includes interest income from financial instruments which does not fall within the scope of this standard. There is no quantitative transition adjustment as at January 1, 2018.