

# 2018

## ANNUAL REPORT



**F1rstOntario**  
CREDIT UNION

“I wish to thank all of you, our Members for your support and trust in FirstOntario and your Board to deliver the best financial products and services while supporting our communities, helping us all to grow and prosper, together.”

~ Carey Smith

# 2018

## FINANCIAL HIGHLIGHTS BOARD REPORT

Every year at FirstOntario brings many opportunities, challenges and successes. 2018 was no exception. We started off the year with some great news from the Ontario Government who introduced several changes which enabled credit unions to be more competitive and also expand on our ability to serve our Members better.

One of the more exciting changes for Members was the increase in the deposit insurance limit for credit union deposits from \$100,000 to \$250,000. The additional changes really served to level the playing field for credit unions as a whole.

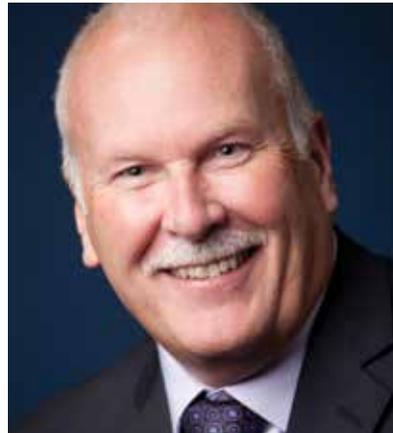
### NEW PRODUCTS, SERVICES AND A NEW BRANCH TOO

In 2018, FirstOntario introduced a number of products and services to our Members. These offerings included the unveiling of eight different FirstOntario VISA cards, which included the business, cash-back and U.S. dollar cards.

Our brand new AgrilInvest business account was introduced, taking into account the needs of our local farmers. This account was designed for farmers who are participating in the federal government's AgrilInvest Program. This account helps farmers set aside money that can provide support for emergency planning and other investments to mitigate their risks.

We were also excited to announce new debit cards featuring Interac Flash® technology to our Members. This technology enables you to make purchases under \$100, without having to insert your debit card or enter

**CAREY SMITH**  
Chair, Board of Directors



your PIN in the point-of-sale machine. If the machine supports Interac Flash®, you can just tap your new debit card and go. We also created Hamilton Tiger Cats special edition debit cards complete with Interac Flash®. As a FirstOntario Member with a Tiger Cats debit card in hand, you have access to some great benefits which include a 10% discount at the Tiger Cats Retail Shop at Tim Hortons Field, Pre-game access to the field and of course the popular "Front of the line" access at the FirstOntario Gate on game days.

Service-wise, one of the many things that keeps people with their banks instead of credit unions are the complications that come with switching to another financial institution. At FirstOntario we welcome new Members with open arms, so we wanted to remove this headache. We did this by implementing a new service we call ClickSWITCH. This service enables Members to quickly and securely switch over automatic payments and direct deposits from accounts at other financial institutions to your FirstOntario account, which in turn saves you tremendous time and effort.

And last, but certainly not least, we were very excited to open our brand new Cayuga branch, located at 43 Talbot Street East, just down the street from our old branch. This branch sports the latest technology and look of the FirstOntario branch network. From all reports, our Members are loving the new look, size and location of this branch.



## IN OUR COMMUNITIES

At FirstOntario we are firm believers in supporting our communities to the best of our ability. Our cooperative principles are the driving force for our community work. As always, we owe a great deal of thanks to our Blue Wave employee volunteers who are the embodiment of our commitment to helping our communities, not to mention their support of the Student Nutrition Program. This program has helped many thousands of students by providing access to healthy food and snacks throughout the year.

Another community effort that is important to us, is supporting our youth and their higher education. With FirstOntario, any students (not just Members) entering their first or second year of post-secondary education are invited to apply for one of 12 FirstOntario Education Awards valued at \$1,000 each.

Being a valued community partner also extends to small businesses. FirstOntario is proud to help small businesses grow through the FirstOntario Credit Union 1Awards competition. Businesses with up to 50 employees who have been operating for at least two years are eligible to enter. Businesses must have demonstrated measurable growth such as workforce expansion, innovation and an economic impact in their community. Winners share in cash prizes and in-kind services, which are tailored to each company's needs.

## FINANCIAL LITERACY

Tailoring to our Member's needs is a specialty of ours, and FirstOntario's "Each One Teach One" program was introduced in 2018 to aid those in need of financial literacy. Financial Literacy is the education and understanding of various financial areas, including topics related to managing personal finance, money and investing. FirstOntario is now one of more than 80 credit unions across the country that offer this program, which trains FirstOntario employees to deliver personal financial skills workshops.

When it comes to money, learning about it early can help you tremendously in later years. That's why FirstOntario partnered with Teresa Cascioli, former President and CEO of Lakeport Brewing, entrepreneur, philanthropist and author of "M is for Money". This nine-book series is designed to support children's financial literacy in Ontario. We made arrangements with Teresa, to offer the first three books of the series to young Members up to the age of 10 who open a new account. There are then more opportunities to collect the rest of the books when they do further account transactions.

And finally, I would like to remind all Members to tune in to Finance Friday on CHCH TV, every other Friday at 7:15 a.m. when Dave Schurman talks about the world of money and answers questions about everyday financial needs.

## IN CLOSING

I would like to take this opportunity to sincerely thank my colleagues on the Board for their time and ceaseless efforts toward steering FirstOntario on a course for success. Please see the following chart outlining Board attendance and remuneration for fiscal 2018.

I would also like to thank the FirstOntario leadership team for working closely with your Board of Directors to keep our credit union moving forward on the path we have laid out. Of course, all of this would not be possible without our employees working on the front lines and those who support from behind the scenes. Your commitment to providing our Members with the best service on a daily basis is very much appreciated.

Going forward in 2019, we are celebrating 80 years of service to our Members and our communities. We will continue to improve our processes and procedures and ensure employees deliver an outstanding service experience for you with every interaction.

And on that note, I wish to thank all of you, our Members for your support and trust in FirstOntario and your Board to deliver the best financial products and services while supporting our communities, helping us all to grow and prosper, together.

## BOARD ATTENDANCE (2018)

DIRECTOR	POSITION	BOARD MEETINGS HELD	BOARD MEETINGS ATTENDED	BOARD MEETINGS CALLED IN	COMMITTEE MEETINGS HELD	COMMITTEE MEETINGS ATTENDED	COMMITTEE MEETINGS CALLED IN
Martinus Geleynse	Director	8	7	0	13	13	0
Sandra Gribben	Director	17	12	3	19	11	5
Tricia Hellingman	Director	17	17	0	19	19	0
Irene Lowell	Chair, Strategic Oversight Committee	17	17	0	18	18	0
Dianne MacLean	Chair, Governance Committee	17	15	0	19	19	0
Lucy Morton	Director	17	15	1	18	15	1
Lorie Peacock	Chair, Elections Committee	17	15	2	22	20	1
Peter Pennacchietti	Director	17	16	1	18	14	3
Otto Penner	Board Vice Chair	17	16	0	23	22	0
Mike Shepherd	Director	17	8	8	18	9	9
Carey Smith	Board Chair	17	17	0	0	*15	0
Stuart Walker	Chair, Audit & Risk Committee	17	16	0	19	19	0

\*The Board Chair is not a member of any Committee, however, the chair attends various Committee meetings to provide oversight. Martinus Geleynse stepped down from the Board in October 2018. Committee Meetings held varies by the committees Directors are assigned to.

## REMUNERATION SCHEDULE

POSITION	BASE HONORARIUM	MEETING ATTENDANCE PREMIUM	CONFERENCE INTO MEETINGS (VIDEO/PHONE)
Board Chair	\$35,000	*\$325	\$225
Vice Chair	\$22,000	\$325	\$225
Committee Chair	\$16,000	\$325	\$225
Audit & Risk Committee Chair	\$18,000	\$425	\$225
Audit & Risk Committee Directors	\$15,000	\$425	\$225
Director	\$12,500	\$325	\$225

The above table is the Remuneration Schedule approved by the Board for 2018. The difference in base honorarium is driven by the time commitment required for each position. \*Please note the Board Chair receives a meeting attendance premium for Board meetings only.

# DELIVERING COMMUNITY IMPACT

Our commitment to being more than a financial institution continues to be our focus at FirstOntario Credit Union. Our strength is in our employees, our Members and in the communities we serve. We understand that the vibrancy and health of the places we live, work and play are a reflection of the decisions we make as a business. That is why we invest our profits in programs and initiatives that will deliver a positive and long-lasting impact in our communities.

## SPONSORSHIP SUPPORT

FirstOntario supports a variety of events and organizations that make a difference in our communities and for our Members. The areas that we align ourselves with are local to where FirstOntario operates and create a positive impact in the local community with a focus on youth health, wellness and wellbeing; and events synonymous with the local community or region.

In 2018, we supported over 100 events and organizations across our geographic footprint, contributing more than \$375,000 in community sponsorships.

We made a significant impact on our communities during the holiday season. During the month of December, branches and departments across all our regions held raffles, collected food and toy donations, gathered warm clothing and sponsored families. More than \$18,400 was donated to a variety of charities and organizations in our communities through dress down funds, raffles and donations. Employees also gave almost \$14,000 through the United Way payroll deduction program.



## BLUE WAVE EMPLOYEE VOLUNTEERISM

Our Blue Wave employee volunteers are an expression of the vision, mission and values of our credit union. When we volunteer or support our fellow Blue Wave volunteers, we live our commitment to being a hands on contributor to our communities. In 2018, the Blue Wave team volunteered over 2,000 hours to our communities, doubling our volunteer hours from the previous year and increased our Blue Wave volunteers by 10%.

Volunteerism at FirstOntario is reflected through employees across all our locations who believe strongly in the value they are creating in the community by volunteering their time. This year, FirstOntario recognized five employee volunteers who reached their 96-hour milestone and one who reached a second milestone in volunteer support. These inspiring community leaders were recognized for their contributions with a donation to the charity of their choice.

A total of \$3,750 was donated on behalf of these volunteers. Ronald McDonald House South Central in Hamilton was one of the charities that benefitted. Manager of Development and Donor Relations, Chris Over, said;

“Congratulations on this amazing program. It is so great that you recognize the accomplishments of your people and the hours they give back within the community. The impact is huge!”



**Listed below are some of FirstOntario's community partners:**

- Hamilton Health Sciences Foundation
- The Canadian Mental Health Association
- Wesley Urban Ministries
- Good Shepherd
- The Canadian Cancer Society
- Burlington Community Foundation
- Kerrfest
- Joseph Brant Hospital Foundation
- Oakville Ribfest
- Out of the Cold
- Rankin Run
- Hospice Niagara
- Niagara Health System
- Local Santa Claus Parades
- Norfolk County Fair
- Whispering Hearts Horse Rescue
- Wise Guys / Gals
- Holiday gift wrapping at local malls

**STUDENT NUTRITION PROGRAMS**

FirstOntario continues to focus on supporting student nutrition programs; an important way we highlight our support of youth, health and wellness. Since 2014 we've provided a significant amount of funding and Blue Wave volunteer support to programs that gave school-age children access to healthy and nutritious breakfast, lunch and snack programs. Research shows that nutrition contributes to the success of academics. Studies have also shown that nutritious meals and snacks, that are made available through these programs, can improve attendance, increase student participation in the classroom and in physical education programs, promote healthy eating habits, and improve food-related skills and knowledge as well as social skills. FirstOntario supports the health and wellness of our youth.

FirstOntario's support continues with over \$1 million invested in the last five years in programs in our communities. In this school year alone - September 2018 to January 2019 - 194 hours were donated by 40 dedicated volunteers to 32 schools across our communities and have supported efforts for a program that feeds over 50,000 kids, each day, across all our communities. Since we began our volunteer support, 2,860 hours have been volunteered with Student Nutrition Programs.

In 2018 we streamlined our approach to funding and work directly with the agencies to further ensure that our support is having the most impact to students and nutrition. Our investment in ensuring a healthy, productive start to the day for students is an important part of how we work to improve the lives of our Members and our communities and use our profits for a higher purpose.

**Some of the events & organizations supported through sponsorship include:**

- Student Nutrition Programs
- Bulldogs Foundation
- Coldest Night of the Year
- Youth sports teams across our communities
- Chambers of Commerce across our communities
- United Way
- Hospice Niagara
- Good Shephard
- St Joseph's Villa Foundation



“We look to continue to build healthy, growing and vibrant communities.”

## YOUTH EDUCATION & LEADERSHIP OPPORTUNITIES

Our focus on youth and providing leadership opportunities and education support continued in 2018. A total of twelve students were provided a \$1,000 FirstOntario Education Award to support post-secondary studies. The successful candidates were assessed on criteria such as leadership skills, volunteer activities, educational goals and their contribution to the local community. The applicants were outstanding in their achievements and their commitment to volunteerism.

One young Member was also sponsored as part of our support of Co-operative Young Leaders camp participation. Attendees develop leadership and communication skills, enjoy team building activities with other young people including swimming, hiking and social activities and learn about the cooperative values that make credit unions unique.

This year also saw our continued support of bursaries at post-secondary institutions across our different regions including McMaster University, Brock University, Mohawk College, Niagara College and Fanshawe College. This is a continuation of a long-standing tradition that FirstOntario supports today.

## FINANCIAL LITERACY

Introduced in 2017, the Each One, Teach One (EOTO) program has enabled us to deliver financial literacy workshops across all our regions in an effective and demonstrable way. In the spirit of credit union partnership, Vancity Credit Union created and made the EOTO program available to credit unions across Canada with the commitment to delivering basic financial literacy and skills on such topics as basic budgeting, building a healthy credit history, identity theft and fraud prevention, RRSPs and TFSA's, home readiness, and much more.

We have 41 financial literacy coaches who delivered over 20 workshops to almost 1,000 people this past year. This community outreach allows us to deliver important financial concepts and create understanding in a way that is approachable and easy to understand. In addition to our efforts to promote financial literacy in the community, we have also committed to strengthening our relationships with our business Members through the promotion of our Member Value Program (MVP). The MVP embodies not only the value that FirstOntario offers but the values we

represent. One of the benefits of the MVP that Business Members have taken advantage of is the delivery of onsite financial literacy coaching for their staff. By increasing financial empowerment and education, we can enable an opportunity for people to gain control of, and actively manage their own financial well-being.

In partnership with entrepreneur and author Teresa Cascioli, we launched our support of the M is for Money® nine-book series. This program supports children's financial literacy by providing books to any Member who opens a new account for a child up to the age of 10. We are proud to have also shared this important series through our support of the Town of Oakville's Swim to Survive Program, as part of FirstOn the Field Flag Football program offered by the Hamilton Tiger-Cats, and as part of our Hamilton Bulldogs Game day activities. By providing the basic knowledge to our youth, they can make better financial choices and create achievable financial goals in their adulthood. By promoting financial literacy to families we help create communities that can grow and prosper.



## **AFFORDABLE HOUSING**

Housing affordability continues to be an issue in the communities we serve. Our partnership with PennTerra and Bethlehem Housing and Support Services is a symbol of the type of projects that we want to develop. It is a long term project that will provide affordable rental housing and support services solutions for individuals and families facing issues of homelessness, physical disability, mental health, domestic violence and family breakdown. This innovative project is expected to provide 80 affordable housing units in downtown St. Catharines. Construction has now begun and is expected to be completed by 2020.

## **LOOKING FORWARD**

We are proud of the work we completed in 2018. As we enter 2019, we look to continue to build healthy, growing and vibrant communities. In order to accomplish this goal we need to concentrate on the issues that are most material, and relevant, to our role as a financial institution, and where we have the skills and resources to make a meaningful impact both inside and outside our locations. The key pillars of our focus in 2019 are as follows:

- Youth Health and Wellness
- Providing Access to Safe and Affordable Housing
- Creating Sustainable Financial Futures

By leveraging our credit union's unique skills, expertise and commitment, we will bring about meaningful change, and create stronger communities for all.

# FINANCIAL HIGHLIGHTS



## OVERVIEW

As a co-operative financial institution, FirstOntario truly cares about improving the lives of our Members and communities. Our vision is to be First in our communities by being more than a credit union. We do this by offering an enriched retail banking experience, including great rates and lower fees while actively supporting the communities we all live in. FirstOntario Members also have a voice in how our credit union is run, by voting for the Members they feel will best represent them on the Board or to run for election to the Board themselves.

Today, FirstOntario is in a low interest rate and low margin environment. Due to this environment, a new financial model is necessary to sustainably provide financial services to our Members.

During 2018, assets under management growth was 7.5% (2017 - 9.2%), growing to \$5.5 billion. Assets under management include on and off balance sheet Member loans, Member deposits, Member investments managed by our wealth advisors and Member investment shares.

Our new financial model was designed to support the revenue being generated by margin and to allow FirstOntario to grow the capital required to support the growth in services for our Members. Other sources of revenue, outside of daily banking charges, are required. In addition to looking at new products and

services, FirstOntario is strategically and sensibly accumulating a portfolio of investments and using the wholesale financial markets associated with insured mortgages to obtain non-margin financial income to grow capital and to support the costs of providing expanded financial services to our Members.

In 2018 we continued to make significant progress in implementing our strategic plan:

### RETAIL BANKING EXPERIENCE

- Opened our new Cayuga branch in November
- Installed a Personal Assisted Teller machine at our Stoney Creek branch - thereby extending the branch hours
- Launched our Tiger Cats branded Interac Flash® debit cards
- Launched our new Member Value Program to employees of businesses and organizations within our communities

### NEW FINANCIAL MODEL

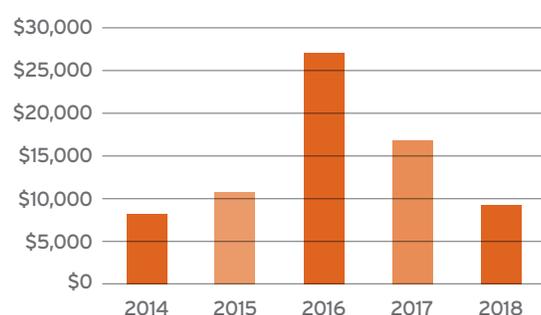
- Invested a net additional \$74.2 million (2017 - \$29.8 million) in real estate, including the development of a geared to income multi-residential property, a portfolio of professionally managed funds and a portfolio of personal loans
- Used wholesale financial markets to earn revenues of \$6.1 million (2017 - \$7.5 million) in various securitization programs



- In July, FirstOntario Insurance Brokerage Inc. opened up for business to assist Members in sourcing competitive home and automobile insurance. During 2019, a limited offering of business insurance products is planned

The following is a chart of pre-tax operating earnings over the past five years.

### PRE-TAX INCOME AMOUNTS IN THOUSANDS



Our 2018 pre-tax income was \$9.4 million (2017 - \$16.6 million); a decrease of \$7.2 million over 2017. The decrease was driven by lower margins, higher loan loss provision and higher operating expenses offset by higher non-margin income.

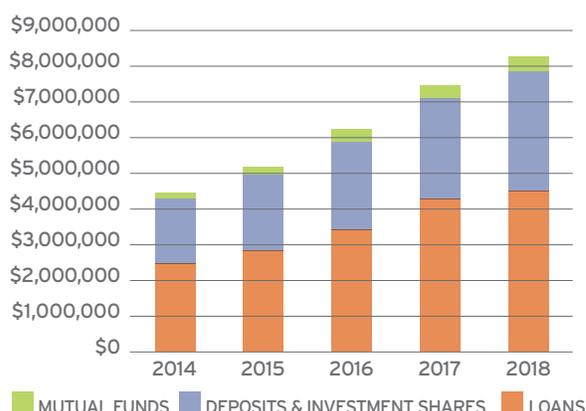
During 2018, net interest and other income was \$93.9 million (2017 - \$91.7 million), an increase of \$2.2 million. Strategic non-margin income increased by \$5.2 million, offset by lower operational non-margin income, higher provision for impaired loans and lower margin due to lower balance sheet growth and lower yields. Expenses of \$84.5 million (2017 - \$75.0 million) increased by \$9.5 million. Salaries and benefits increased by \$5.4 million, technology costs by \$1.6 million with the remaining expenses increasing by \$2.5 million.

### FUNDS UNDER MANAGEMENT

At FirstOntario, we exist to help our Members meet their credit, deposit and investment financial needs. A key indicator of our success is the total loans, deposits and investments Members have with us - Funds Under Management ("FUM"). Our FUM growth was 10.5% (2017 - 12.3%), increasing to \$8.2 billion.

Members entrusted with us an additional \$0.8 billion (2017 - \$0.8 billion) in loans, deposits and investments in 2018. Loans are a significant financial need for our Members with our loan portfolio increasing \$272 million (2017 - \$349 million) or 6.5% due in part to a slower mortgage market and a reduction in our commercial loan portfolio. Our loan portfolio growth accounted for 35% (2017 - 43%) of our FUM growth. Loans are funded by Member deposits and external funding partners. Members' deposits and investment shares grew by \$507 million (2017 - \$447 million) or 17.5%. Finally, our Members' mutual fund holdings increased by \$1.7 million (2017 - \$22.1 million) or 0.5%. Mutual fund holdings growth was a result of net new member investments offset by negative market returns during 2018.

### FUNDS UNDER MANAGEMENT AMOUNTS IN THOUSANDS



## LOANS PAYABLE & SECURITIZATION LIABILITIES

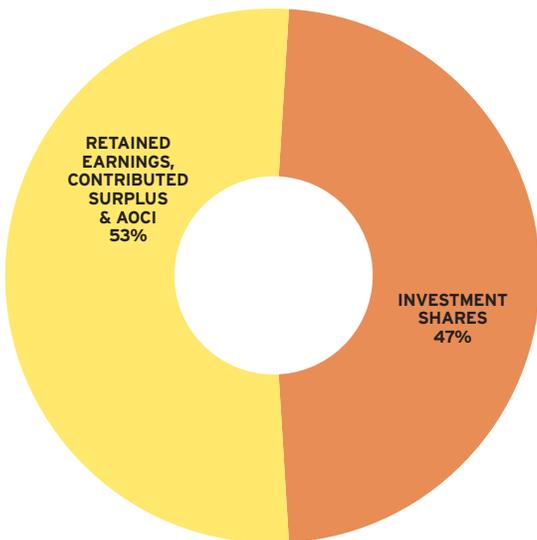
During the year, loans payable and securitization liabilities decreased by \$194 million to \$608 million (2017 - \$802 million) as FirstOntario increased dependency on deposit growth to fund Member loans.

## MEMBERS' EQUITY

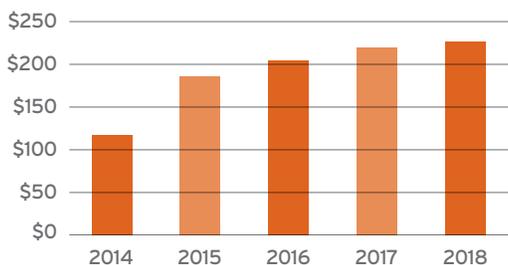
Members' equity increased to \$225.6 million (2017 - \$216.5 million), growth of \$9.1 million (4.2%). Accumulated earnings and other comprehensive income make up 53% (2017 - 52%) of Members' Equity.

Growth in 2018 came from net earnings and an increase in our Accumulated Other Comprehensive Income ("AOCI"). Growth in 2017 and 2016 primarily came from net earnings, while the growth in 2015 was due to a new issue of investment shares and net earnings.

### MEMBERS' EQUITY DECEMBER 31, 2018



### MEMBERS' EQUITY AMOUNTS IN MILLIONS



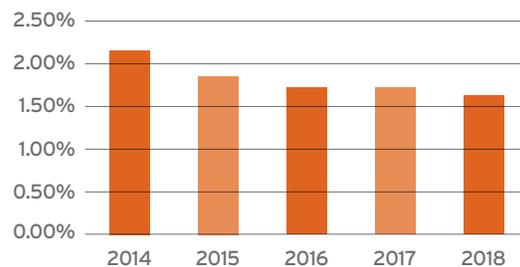
## NET INTEREST INCOME

By definition, net interest income is the difference between interest paid by Members on loans and interest earned on our liquidity reserve deposits less interest paid to Members on their deposits and interest paid on outside debt obligations. FirstOntario derived 67% (2017 - 71%) of its gross revenue from net interest income. The ability to grow net interest income is primarily dependent upon growth in Member loans and deposits.

Net interest income is impacted by changes in interest rates over time (interest rate risk). FirstOntario strives to manage and minimize interest rate risk, sustaining a high but stable net interest income over a number of years.

Net interest income decreased by 2.8% due to lower growth in FUM, Members borrowing for longer terms than deposit terms taken out in a rising interest rate environment and a very competitive deposit market. Net interest income as a percentage of average assets decreased to 1.60% (2017 - 1.73%).

### NET INTEREST INCOME % OF AVERAGE ASSETS



Due to the continued relatively low interest rate environment and continued high levels of competition, FirstOntario's net interest income as percentage of average assets has dropped from 2.13% in 2014 to the aforementioned 1.60% in 2018, a drop of 0.53%. At the same time, expenses as a percentage of average assets have decreased from 2.17% in 2014 to 2.09% in 2018, a drop of 0.08%. In 2016, expenses temporarily dropped as low as 1.55%. FirstOntario is undertaking a review of its processes and expenses in 2019. Streamlining and automating our processes along with increased focus on expense management will improve our retail banking experience while reducing our expenses as a percentage of average assets over the next 2 years.

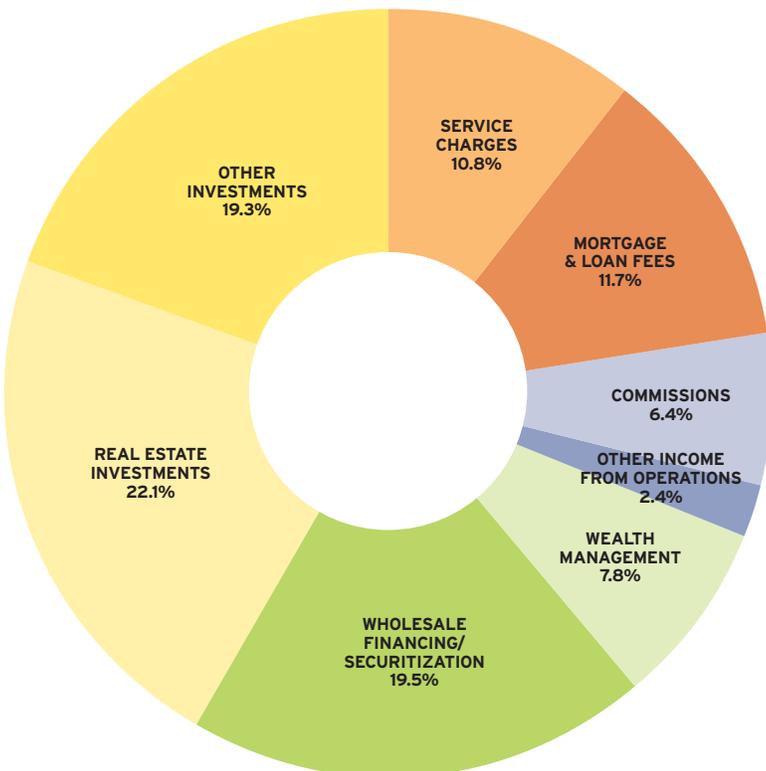
## OTHER INCOME - OPERATIONS & STRATEGIC INITIATIVES

Other income increased to \$31.4 million (2017 - \$26.6 million), which is a return on average assets of 0.78% (2017 - 0.69%). Our peer credit unions in Ontario average 0.50%. As a percentage of total revenues, other income is 33% (2017 - 29%).

The distribution of our other, non-interest income sources is depicted in the following chart:

In Thousands of Dollars	YEAR ENDED DECEMBER 31, 2018		YEAR ENDED DECEMBER 31, 2017	
	INCOME	MIX	INCOME	MIX
<b>OPERATIONS</b>				
Service Charges	\$ 3,394	10.8%	\$ 2,867	10.8%
Mortgage and Loan Fees	3,662	11.7%	4,027	15.2%
Commissions	2,006	6.4%	2,208	8.3%
Other	760	2.4%	1,037	3.9%
<b>STRATEGIC</b>				
Wealth Management	2,458	7.8%	2,165	8.1%
Wholesale Financing/Securitization	6,120	19.5%	7,496	28.2%
Real Estate Investments	6,952	22.1%	4,331	16.3%
Other Investments	6,066	19.3%	2,436	9.2%
<b>TOTAL OTHER INCOME</b>	<b>\$ 31,418</b>	<b>100.0%</b>	<b>\$ 26,567</b>	<b>100.0%</b>

### OTHER INCOME YEAR ENDED DECEMBER 31, 2018



Service fee income increased in 2018 as normal levels of revenue returned post banking system conversion. The decrease in mortgage and loan fees was a result of lower personal and commercial loan growth. The decrease in commissions was a result of a decrease in Creditor Insurance due to lower loan volumes, and a decreased number of Members utilizing CUMIS home and auto insurance with the introduction of FirstOntario Insurance Brokers. In addition, the introduction of our new line of credit card products has resulted in reduced commissions as Members switch over to our new products. We expect to exceed past credit card performance in the future.

Our strategic plan's new financial model currently includes wealth management, utilizing the wholesale financing markets associated with mortgage backed securities contained within programs sponsored by the Canada Mortgage and Housing Corporation, real estate investments that include property development projects, multi-residential and retail commercial complexes, and equity investments in public and private markets. Income from these sources increased by \$5.2 million to \$21.6 million (2017 - \$16.4 million).

In addition, FirstOntario enters into transactions in the normal course of business by which it transfers recognized financial assets directly to third parties or SPE's (Special Purpose Entities). FirstOntario securitizes mortgage backed securities through programs sponsored by the Canada Mortgage and Housing Corporation and other third party programs. In situations where FirstOntario transfers substantially all the risks and rewards of ownership, derecognition of that asset occurs. In some cases, FirstOntario retains the rights to certain cash flows related to these derecognized assets which are recorded in other income.

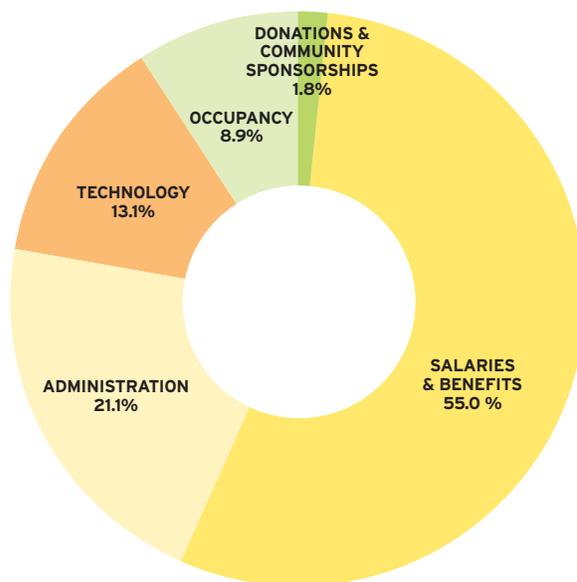
## OPERATING EXPENSES

In 2018, operating expenses were \$84.5 million (2017 - \$75.0 million).

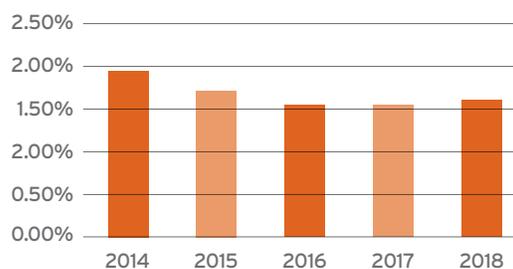
Financial institutions also measure operating expenses as a percentage of average assets under management. As financial institutions grow their assets, expenses assessed as a percentage of average assets should decline. During the year, our operating expenses increased to 1.60% (2017 - 1.54%) as additional

expenses, explained below, were incurred. As mentioned, in 2019 we will review our processes and expenses with the goal of improving our retail banking experience and reducing our expenses as a percentage of average assets under management over the next 2 years.

## NON-INTEREST EXPENSES YEAR ENDED DECEMBER 31, 2018



## OPERATING EXPENSES % OF AVERAGE ASSETS UNDER MANAGEMENT



Salaries and benefits were \$46.5 million (2017 - \$41.1 million). Salaries increased by 8.1% during 2018 due to annual increases, temporary staff increases as we develop efficiencies with our new banking system and the launch of FirstOntario Insurance Brokerage. During 2018, employee benefits costs increased by 32.4% driven by staff increases, higher retirement plan costs and higher group benefit costs. We expect employee benefit costs to return to normal levels in 2019. As a percentage of average assets under management, FirstOntario's salary and benefits expense were 0.88% (2017 - 0.85%).

Other operating expenses were \$38.0 million (2017 - \$33.9 million), an increase of 11.9%. The increase was mainly in technology, community investments and administration. As a percentage of average assets under management, FirstOntario's other expenses were 0.72% (2017 - 0.70%).

## LOAN PORTFOLIO

The following chart summarizes FirstOntario's total loans including on balance sheet and off balance sheet securitized loans. Growth is the percentage period over period increase and the Portfolio Mix is the ratio of a category to the total loan portfolio.

In Thousands of Dollars	DECEMBER 31, 2018		DECEMBER 31, 2017	
<b>TOTAL LOAN PORTFOLIO</b>	<b>\$ 4,496,914</b>		<b>\$ 4,224,136</b>	
	Growth	Mix	Growth	Mix
Personal Loans	(7.6%)	2.7%	(1.3%)	3.1%
Residential Mortgage Loans	11.4%	79.1%	12.1%	75.6%
Commercial Loans	(9.1%)	18.2%	0.6%	21.3%
Total	6.5%	100.0%	9.0%	100.0%

Significant growth continued in our residential mortgage loan portfolio through our branches and due to our continued focus on building relationships with mortgage brokers. New Members as a result of brokered mortgages are then introduced to FirstOntario and the full suite of financial services we offer.

In 2018, our commercial loan portfolio decreased by 9.1% as construction project loans concluded, several loans at maturity did not renew due to a competitive interest rate environment and we did not extend renewal terms on loans with higher risk profiles than our risk appetite, for the most part without loss. We continued to use our cautious approach to attracting new commercial Members, keeping in mind economic challenges. In 2018, we recorded a \$3.3 million anticipated loan loss on an \$11 million loan expected in early 2019. This loan has been in our portfolio for over 15 years earning FirstOntario interest and fees in excess of \$6.3 million. Management took appropriate action to minimize the losses given the circumstances.

Commercial loans are generally secured by mortgages over land and buildings. The geographic and industry diversification within the commercial portfolio continues to improve. As at December 31, 2018, 17% (2017 - 15%) of the on balance sheet loan portfolio is associated with five of our largest commercial Members. Commercial loans are well secured, with average outstanding loan balances at 52% of the value of security as determined by qualified appraisers.

In 2018 approximately \$183 million (2017 - \$272 million) in residential mortgages were securitized. The reduction was in part due to lower levels of available securitizable mortgages.



## ALLOWANCE FOR IMPAIRED LOANS

The allowance for impaired loans is governed by Board policy and reviewed on an annual basis and approved by the Audit & Risk Committee of the Board. With the adoption of IFRS 9 - Financial Instruments on January 1, 2018, the model for determining the allowance has changed from an "incurred loss" model (allowance is recognized when there is evidence that a loss triggering event has occurred) to an "expected credit loss" model (allowance is set up on loan origination). A requirement when IFRS 9 was implemented was to initiate an advanced data analytics model that uses FirstOntario detailed loan level historical data, industry data, and macro-economic data to calculate the allowance for impaired loans. Watch list accounts, delinquencies, credit quality and Member bankruptcies are used by the model. The provision for impaired loans is monitored to ensure compliance with Board policy and regulatory requirements.

This chart provides a summary of our allowance for impaired loans. FirstOntario's loan portfolio continues its

Amounts in Thousands	DEC 31, 2018	DEC 31, 2017
On Balance Sheet Loan Portfolio	\$ 3,597,358	\$ 3,381,962
<b>Allowance for Impaired Loans</b>		
Stage 3 (2018)/Specific (2017)	\$ 4,142	\$ 1,406
Stage 1 and 2 (2018)/Collective (2017)	3,964	6,079
	<b>8,106</b>	7,485
<b>Annual provision for impaired loans</b>	\$ 2,445	\$ 1,642
<b>Net Write-offs</b>	\$ 1,351	\$ 1,615
<b>Impaired loans net of related security</b>		
Impaired loans	\$ 42,538	\$ 22,506
Related security less expected costs	38,396	21,100
	\$ 4,142	\$ 1,406
<b>Delinquency &gt; 90 Days</b>	<b>0.31%</b>	0.28%
<b>% of Loan Portfolio</b>		
<b>Allowance for Impaired Loans</b>		
Stage 3 (2018)/Specific (2017)	0.12%	0.04%
Stage 1 and 2 (2018)/Collective (2017)	0.11%	0.18%
	<b>0.23%</b>	0.22%
<b>Annual provision for impaired loans</b>	<b>0.07%</b>	0.05%
<b>Net Write-offs</b>	<b>0.04%</b>	0.05%
<b>Impaired Loans</b>	<b>1.18%</b>	0.67%

strong performance due to our adherence to conservative lending practices, outperforming industry norms.

Our gross impaired loans increased to \$42.5 million (2017 - \$22.5 million) due to commercial loans including the \$11 million loan referenced above. FirstOntario holds security related to these loans of \$38.4 million (2017 - \$21.1 million). Our 90 day delinquency has increased to 0.31% (2017 - 0.28%) due to commercial delinquency increasing to 1.52%. Once the above referenced loan is written off, our commercial delinquency is expected to decline to historical portfolio levels.

FirstOntario uses an internal risk rating grid to assess and monitor new loans and our loan portfolio, both retail and commercial. The majority of the retail loan portfolio, 87% (2017 - 76%), has risk ratings of "B" or better. The commercial portfolio has 98% (2017 - 92%) of loans rated as Satisfactory or Superior. These measures and the performance of the loan portfolio indicate FirstOntario has a very strong lending operation.

## INVESTMENTS

FirstOntario's investment portfolio is internally segregated into two main categories - strategic investments and statutory investments. Statutory investments are required to be a member of Central 1 or as a past member of Credit Union Central of Ontario Limited. Strategic investments are those investments tied to the new financial model pillar of our strategic plan.

Amounts in Thousands	2018	2017
<b>Strategic Investments</b>		
Managed Funds	\$ 81,330	\$ 25,151
Real Estate Joint Ventures	87,465	74,631
Loans	10,779	5,658
Retained Rights - loan securitizations	37,680	39,548
	<b>217,254</b>	144,988
<b>Statutory Investments</b>		
Liquidity Reserve Deposits	256,605	240,181
Shares - Central 1	18,308	19,275
CUCO Cooperative Association	87	87
	<b>275,000</b>	259,543
<b>Other Investments</b>	<b>3,599</b>	3,765
	<b>\$ 495,853</b>	\$ 408,296

Strategic investments as at December 31, 2018 represent 5.16% (2017 - 3.73%) of total assets. Managed funds is a diversified portfolio of investments actively managed by external investment advisors. FirstOntario has entered into agreements to jointly own and develop retail mall complexes and develop multi-tenant residential properties. Retained rights are associated with our wholesale financial market transactions involving securitized insured mortgages.

Our statutory investments include liquidity reserve deposits required by member credit unions of Central 1 equalling 6% of FirstOntario's assets. In addition, there are investments in affiliates including Central 1 shares and shares in CUCO Cooperative Association.

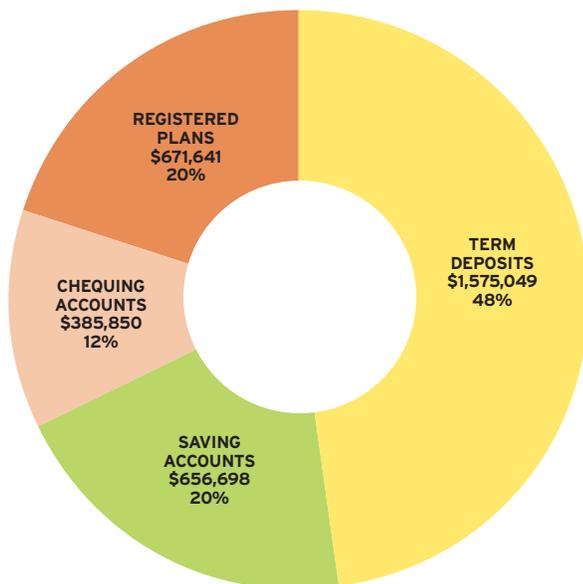
### Investment in Affiliates

FirstOntario is a member of Central 1 Credit Union - whose primary function is to maintain a liquidity pool for use by its member credit unions. This liquidity arrangement means that a credit union Member's deposits are backed by a larger organization and by the combined strength of a network of approximately 100 affiliated credit unions in Canada.

### DEPOSIT PORTFOLIO

FirstOntario grew its deposit base 18.1% (2017 - 19.1%). Term deposit accounts increased by 41%. Savings accounts decreased by 5% as Members shifted their deposits to terms. Chequing grew by 11% and registered plans increased by 6%. The current average cost of Member deposits is 2.26% (2017 - 1.83%), an increase due to rising market interest rates. Increasingly consumers are using deposit brokers to place deposits at financial institutions. As at December 31, 2018, 15% (2017 - 8%) of deposits were sourced from deposit brokers with the portfolio having greater than 50% maturing beyond the next 12 months.

#### DEPOSITS DECEMBER 31, 2018



# RISK MANAGEMENT

The Board of Directors have overall responsibility for the oversight of FirstOntario's risk management. Board policy sets FirstOntario's philosophy to have appropriate and sensible policies, procedures and controls to manage operational risk. The Board's Audit and Risk Committee responsibilities in risk management include:

- The development and monitoring of controls to support the enterprise risk management framework,
- The review of enterprise risk reports issued to the Board, and
- The management of risk and controls related to the safeguarding of assets and financial reporting.

## ENTERPRISE RISK MANAGEMENT

Enterprise Risk Management ("ERM") provides a uniform process to identify, measure, treat and report on significant risks within FirstOntario. ERM is a discipline to enable the achievement of our strategic plan objectives within the Board of Director's approved risk appetite.

During 2018, the Audit & Risk Committee reviewed and discussed FirstOntario's complete inventory of risks, paying special attention to significant (i.e. top ten) and emerging risks. The Audit & Risk Committee also reviewed the process Management undertook in documenting and rating the effectiveness of controls in place to reduce inherent risks within the Credit Union.

Through the Internal Audit department, FirstOntario conducted testing of documented controls to provide a level of independence and assurance that the controls as stated are in fact effective.

FirstOntario takes both integrative and holistic approaches to managing and mitigating identified risks.

FirstOntario's approach to managing and mitigating specific risks is as follows:

## CREDIT RISK

Credit risk is the risk of financial loss to FirstOntario if a Member or counterparty to a financial instrument fails to meet its contractual obligations. This risk primarily arises from FirstOntario's loans and advances to Members.

FirstOntario's lending philosophy is established by its Board approved Credit Risk Management policy.

Our Credit Risk Management policy provides detailed guidance to Management that includes:

- Creating operational credit policies covering eligible purposes of loans, collateral requirements, credit assessment, risk rating and reporting, and compliance with regulatory requirements.
- Establishing a lending authority structure for the approval and renewal of Member loans.
- Limits on concentrations of exposures related to Members, industries and geographic locations.

## INTEREST RATE RISK

Interest rate risk is the risk to net interest income associated with changing interest rates on FirstOntario's interest bearing loans and investments and interest bearing deposits and other debt obligations.

FirstOntario is required by legislation to measure and manage interest rate risk. FirstOntario complies with this requirement through its Board approved Structural Risk Management Policy. FirstOntario uses sophisticated industry standard tools and techniques to aid in monitoring and controlling interest rate risk within sensible limits. An Asset and Liability Committee, made up of senior Management, reviews interest rate risk on a regular basis.

“Board policy sets FirstOntario’s philosophy to have appropriate and sensible policies, procedures and controls to manage operational risk.”

One of the tools used is an income simulation model. The purpose of the model is to simulate the 12-month net interest income of the current mix of business taking into account current and forecasted interest rates (yield curves), growth assumptions on new business (loans and deposits), behaviours of Members (impacted by prepayment assumptions) and competitive pricing conditions. The main form of interest rate risk measurement is the usage of a parallel shock test that is sustained for a 12-month period. The purpose of the shock test is to have a single test that will replicate many of the unexpected interest rate risks facing FirstOntario. For this purpose, FirstOntario uses a 1% shock rate. However, depending on market and economic conditions, this shock rate can and will be amended from time to time.

If Management determines that the level of interest rate risk is too high or approaching Board policy limits, various strategies are evaluated and implemented. Some of these strategies are internally focused such as product pricing on loans and deposits while other strategies are external. With respect to external strategies, FirstOntario will engage in the use of interest rate derivatives, primarily where FirstOntario will swap fixed rate funding for floating rate funding or vice versa.

## LIQUIDITY RISK

FirstOntario is required by the Credit Union Act to maintain certain levels of liquidity. Under the Regulations, FirstOntario must establish and maintain sensible levels of liquidity that are sufficient to meet its cash flow needs, including deposit withdrawals and all other obligations as they come due. FirstOntario complies with this requirement through its Board approved Liquidity Risk Management Policy. The policy addresses limits on the sources, quality and amount of liquid assets to meet normal operations (day to day commitments including Member withdrawals), contingency funding for significant deposit withdrawals and regulatory requirements.

The Board’s policy requires operational liquidity to be maintained within a range of 8% to 16%. Generally, Management targets liquidity levels in the 9% to 11% range thereby allowing FirstOntario to maximize our net interest income returns. On occasion, FirstOntario’s liquidity levels do drop to the 8% to 9% range. When this happens, steps are taken to restore liquidity levels to above 9%. To ensure FirstOntario continually maintains the minimum liquidity levels, Management measures and monitors liquidity levels on a daily basis. Management also prepares detailed monthly and three-month cash flow forecasts. If there is any risk of liquidity dropping below the policy minimum of 8% a plan for corrective action would be developed and implemented. As at December 31, 2018, FirstOntario’s liquidity ratio was 11.32% (2017 - 11.16%).

To ensure FirstOntario has adequate sources of liquidity, Management has developed a liquidity plan, which sets out various liquidity sources. Our primary liquidity is derived internally from Member deposits. FirstOntario has three external liquidity sources. These include funding from deposit brokers, securitization of residential mortgage loans through the issuance of Mortgage Backed Securities and Canada Mortgage Bonds and the sale of commercial mortgage loans through other credit unions and other credit union affiliated partners. As part of our contingency liquidity plan, FirstOntario has available \$264 million in operating loan facilities with Central 1 Credit Union and Caisse Centrale Desjardins. On December 31, 2018 there were no outstanding balances. These loans are generally used to fund mortgages until they are securitized at which time the loans are replaced by long term debt associated with the securitization.

## FOREIGN EXCHANGE RISK

FirstOntario provides Members with the opportunity to buy and sell U.S. dollars (cash, cheques and drafts). In addition, FirstOntario provides Members with U.S. dollar deposits (chequing, savings and short-term deposits). By providing these services, FirstOntario is exposed to foreign exchange risk, which is the risk to income that could result from changes in U.S. currency rates.

To measure and control our exposure to U.S. currency risk, FirstOntario tracks the net U.S. position (U.S. dollar assets less US dollar liabilities) on a daily basis. Within our Liquidity Risk Management Policy, the maximum US currency exposure FirstOntario can take is \$500,000. Management operates on a day-to-day basis at a lower limit of between \$200,000 and \$300,000.

To ensure we maintain our foreign exchange risk within policy limits, FirstOntario enters into various foreign exchange forward contracts (contract to purchase US dollars in the future at an agreed upon exchange rate).

## CAPITAL RISK MANAGEMENT

Capital is monitored monthly on both a capital leverage and a risk weighted basis. During 2018, FirstOntario conducted an internal capital adequacy assessment process (ICAAP) for the third year. In general terms, the iCAAP is an assessment of FirstOntario's risk profile and determines if FirstOntario has enough capital to support that risk profile. The iCAAP included a three year financial forecast and is an important component of the annual planning process. Future capital requirements are based on planned asset growth, strategic investments and fixed asset acquisition plans. The iCAAP indicated FirstOntario's capital levels are \$38 million above the iCAAP and ERM risk requirements.

The following chart summarizes FirstOntario's capital position for 2018 and 2017:

Amounts in Thousands	DEC 31, 2018	DEC 31, 2017
<b>CAPITAL</b>	<b>\$ 252,559</b>	<b>\$ 244,879</b>
<b>Leverage ratio</b>	<b>5.99%</b>	6.29%
Minimum regulatory limit	<b>4.00%</b>	4.00%
<b>Risk weighted ratio</b>	<b>12.37%</b>	13.02%
Minimum regulatory limit	<b>8.00%</b>	8.00%
<b>Tier 1 capital</b>	<b>\$ 244,492</b>	<b>\$ 236,006</b>
% of total capital	<b>96.81%</b>	96.38%
<b>Tier 2 capital</b>	<b>\$ 8,067</b>	<b>\$ 8,873</b>
% of total capital	<b>\$ 3.19%</b>	\$ 3.62%

On both the leverage and risk weighted ratio basis, capital is well in excess of regulatory minimums. In addition, our Tier 1 capital was 96.81% on December 31, 2018, and is well in excess of the regulatory minimum of 50%.



“During 2018, FirstOntario conducted an internal capital adequacy assessment process (iCAAP). The iCAAP indicated FirstOntario’s capital levels are \$38 million above the iCAAP and ERM risk requirements.”

## SUMMARIZED CONSOLIDATED STATEMENT OF FINANCIAL POSITION

December 31, 2018 with comparative figures for December 31, 2017, December 31, 2016, August 31, 2015 and August 31, 2014					
Amounts in Thousands	2018	2017	2016	2015	2014
<b>Assets</b>					
Loans to members	\$ 3,609,006	\$ 3,393,395	\$ 3,382,458	\$ 2,717,822	\$ 2,289,017
Cash	62,317	43,098	43,026	94,794	35,878
Investments	495,853	408,296	355,329	255,470	186,060
Fixed assets	39,109	38,201	35,715	23,736	22,483
Other assets	6,109	5,899	1,639	937	1,673
Derivative assets	443	1,383	4,010	1,407	1,524
	<b>\$ 4,212,837</b>	<b>\$ 3,890,272</b>	<b>\$ 3,822,177</b>	<b>\$ 3,094,166</b>	<b>\$ 2,536,635</b>
<b>Liabilities and Members' Equity</b>					
Members' deposits and shares	\$ 3,332,404	\$ 2,820,396	\$ 2,371,206	\$ 2,002,221	\$ 1,857,874
Loans payable and securitization liabilities	608,088	802,382	1,198,796	885,654	540,232
Other liabilities	45,573	49,660	46,647	22,257	20,991
Derivative liabilities	1,195	1,329	2,118	4,443	3,179
Investment shares	106,934	104,208	103,246	97,332	38,373
Retained earnings and contributed surplus	121,649	116,188	104,097	86,966	80,003
Accumulated other comprehensive loss	(3,006)	(3,891)	(3,933)	(4,707)	(4,017)
	<b>\$ 4,212,837</b>	<b>\$ 3,890,272</b>	<b>\$ 3,822,177</b>	<b>\$ 3,094,166</b>	<b>\$ 2,536,635</b>

## SUMMARIZED CONSOLIDATED STATEMENT OF INCOME

For year ended December 31, 2018 with comparative figures for year ended December 31, 2017, the sixteen month period ended December 31, 2016, and for the years ended August 31, 2015 and August 31, 2014					
Amounts in Thousands	2018	2017	2016	2015	2014
<b>Interest Income</b>	\$ 132,950	\$ 124,751	\$ 151,120	\$ 102,193	\$ 90,893
<b>Interest Expense</b>	68,036	57,985	71,669	50,384	41,734
<b>Net Interest Income</b>	64,914	66,766	79,451	51,809	49,159
Provision for loan losses	(2,445)	(1,642)	(1,542)	(1,464)	(1,998)
Other income	31,418	26,567	33,731	15,650	11,311
<b>Net Interest and Other Income</b>	<b>93,887</b>	<b>91,691</b>	<b>111,640</b>	<b>65,995</b>	<b>58,472</b>
<b>Operating Expenses</b>					
Salaries and employee benefits	46,504	41,096	46,018	29,899	27,060
Administrative	17,856	15,847	18,302	12,132	12,339
Technology	11,084	9,533	9,850	6,495	5,380
Occupancy	7,485	7,190	8,972	5,909	4,972
Donations and community sponsorships	1,550	1,380	1,254	775	464
<b>Total Operating Expenses</b>	<b>84,479</b>	<b>75,046</b>	<b>84,396</b>	<b>55,210</b>	<b>50,215</b>
<b>Income Before Income Taxes</b>	9,408	16,645	27,244	10,785	8,257
Income taxes	1,339	3,434	5,075	2,095	1,355
<b>Net Income for the Period</b>	<b>\$ 8,069</b>	<b>\$ 13,211</b>	<b>\$ 22,169</b>	<b>\$ 8,690</b>	<b>\$ 6,902</b>

Certain comparative information has been reclassified to conform to the financial statement presentation adopted in the current year. Further detailed information on our 2018 financial results can be obtained from our 2018 Financial Reports available online at FirstOntario.com (<https://www.firstontario.com/about-us/governance/our-annual-reports/>).



**FirstOntario**  
C R E D I T U N I O N

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