FIRST WEST CREDIT UNION **2017 ANNUAL REPORT**

Risk Report

Management's Discussion & Analysis

FIRST WEST
CREDIT UNION

Risk Report

ENTERPRISE RISK MANAGEMENT

First West Credit Union operates a diversified financial operation. Management recognizes that taking risk is required in operating a successful financial organization. Our business activities expose us to a variety of risks throughout the organization and our ability to manage these risks is a key pillar in maintaining a strong credit union. In addition to our unique model with its locally known brands, we operate specialized subsidiary operations that require specific risk management. Furthermore, regulatory reporting requirements continue to increase, which helps strengthen both First West and our industry.

GOVERNANCE OF RISK MANAGEMENT

At the highest level, oversight and awareness of significant risks is a key accountability of the board. The board of directors:

- Approve the credit union's Enterprise Risk Management Framework
- Define the credit union's risk appetite
- Understand the key risks to which the credit union is exposed
- Establish prudent risk management governance and policy
- Review and approve the Enterprise Risk Governing Policy and other related risk policies on an annual basis
- Gain assurance that First West has an effective risk management process in place
- Gain assurance that the risk management policies are adhered
- Assess and monitor the level of risk and control over the risks through receipt of reports from management, the regulator and others (including internal and external auditors), and by making enquiries in order to determine if risk levels are appropriate
- Gain assurance that First West has established appropriate risk tolerance and appetite thresholds

Management fulfills the board's direction to manage risk by employing a recognized enterprise risk management methodology. In principle, this requires management to take an explicit approach to the identification and aggregation of risk, to the measurement and stress testing of risks identified, and to respond to risk in order to reduce or optimize the risk to an acceptable level.

CORPORATE RISK MANAGEMENT

First West Credit Union maintains a corporate risk division that is led by the chief financial officer (CFO) and senior vice-president, risk. The SVP risk reports to the CFO and to the audit and risk management committee of the board of directors. The department is segregated from other business units and is responsible for reporting and aggregating risks at their residual levels and keeping management and the board informed. The corporate risk team supports management in the area of enterprise risk management and regulatory compliance management and is a resource to the board and senior management team in the development of policies and monitoring activities and tools.

The corporate risk team provides the following services:

- Identification of risks in conjunction with business leaders and escalates where tolerance is exceeded
- Development of measurement systems for risks
- Coordination or reporting on stress and scenario testing
- Ensuring that policies and procedures are established by the risk owner to manage risks
- Development of risk tolerance limits in accordance with the board-approved risk appetite
- Monitoring of risk positions against approved risk tolerance limits
- Reporting of results of risk monitoring and assessment to senior management and to the board through the audit and risk committee on a quarterly basis
- Maintaining and testing the business continuity plan

The primary objectives of our risk management program include:

- Maximizing earnings and return on capital within acceptable and controllable levels of risk
- Providing for growth that is sound, profitable and balanced without sacrificing the quality of service
- Managing and maintaining policies that are consistent with the short- and long-term strategic goals of the board
- Providing recommendations to improve efficiency and effectiveness of controls

RISK CULTURE

First West's risk-management culture is embedded throughout the organization. Employees at all levels of the organization share a common philosophy on risk. Every employee is accountable for achieving the best results for his or her business unit and for First West as a whole. Risk management is aligned with the organization's vision and strategy, and is embedded within our management practices. Business decisions are made at all levels of the organization and every team member has a role in managing risk, including identification, communication and escalation of risk concerns.

Risk Philosophy

Our risk philosophy is based on the premise that First West is in the business of accepting risks for appropriate return. In conducting its business activities, First West—driven by member expectations and the need for sustainable growth and competitive positioning in the marketplace—will accept risks that help meet these needs through the strategic objectives of the organization.

First West's enterprise risk management (ERM) framework and risk appetite framework are the primary mechanisms for operationalizing our risk philosophy.

Risk Strategy

First West's ERM framework is neccessarily linked to the credit union's overall vision, mission and business objectives. The same set of internal (strengths and weaknesses) and external (opportunities and risks) factors used in our business strategy are fully considered in the formation of our risk appetite. The use of these same factors reflects the belief that risk appetite and business strategy need to be fully aligned and, ultimately, mutually reinforcing.

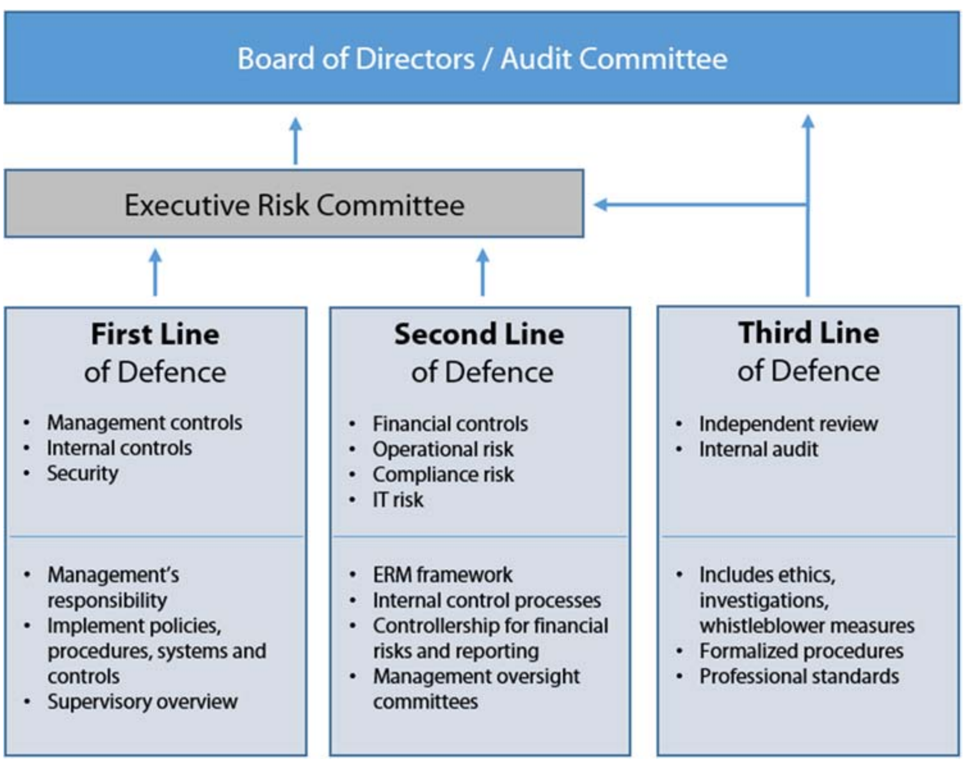
First West seeks to allocate its risk-taking capacity in a manner that generates sufficient capital to provide member benefits and profitable growth. This implies that higher levels of risk appetite can be allotted to those risks most closely aligned with our vision, mission, risk management capabilities, member value creation and other risk preferences.

Stakeholder Interests & Risk Appetite

First West's risk appetite accounts for the respective interests of a number of key stakeholder groups, including members, employees, the communities in which First West operates and financial regulators. First West appropriately balances the various needs, expectations, risk and reward perspectives, and investment horizons of these stakeholders.

THREE LINES OF DEFENCE

First West has adopted the Three Lines of Defence model to help provide a consistent, transparent and clearly documented allocation of accountabilities and segregation of functional responsibilities. This segregation of responsibility helps to establish a robust control framework that improves our understanding and encourages the continuous improvement of the management of risk at First West.



First Line Responsibilities

In general, some of the key first line of defence risk-related responsibilities include:

- Conducting business and taking various risks to meet strategic objectives and performance goals within our risk appetite
- Identifying, managing and mitigating risks in day-to-day business operations
- Identifying opportunities to optimize risk and responsibilities for ongoing effectiveness of controls
- Operating within risk tolerance limits, rules, laws, regulations and policies

Second Line Responsibilities

In general, some of the key second line of defence risk-related responsibilities include independent challenge, independent assessment, coordination and risk monitoring, as well as providing risk management advice. These activities manifest in the following ways:

- Supporting the board and executive risk committee in developing the enterprise risk management policy, enterprise risk management framework, risk appetite framework and various risk management policies
- Providing continuous oversight of the first line of defence, defining risk measurement methodology and developing risk models and tools, challenging business strategy, monitoring emerging risk trends, and identifying emerging risks
- Independently validating risk measurement and risk assessments
- Monitoring and reporting risk exposures to the executive risk committee and the board
- Providing advice on mitigation, framework, appetite and assessment/quantification of risk approaches

Third Line Responsibilities

The internal audit function executes the third line of defence. Third line of defence responsibilities are distinct from first and second line of defence responsibilities and include:

- Providing independent assurance to the audit committee as to the effectiveness and appropriateness of, and adherence to, company policies, by means of independent auditing of both first and second lines of defence
- Providing updates to the executive risk committee on its risk-related interactions with the regulators as the third line of defence
- Reviewing adherence to controls, policies, rules and regulations
- Identifying operational weaknesses and recommending improvements, as well as tracking remediation actions.

Executive Risk Committee Accountabilities

The executive risk committee is held responsible for:

- Reviewing the enterprise risk management framework and the risk appetite framework approved by the board annually
- Evaluating changes in the organization and its enterprise risk practices

- Identifying necessary amendments and making recommendations for such changes to the board for its consideration.

Board Accountabilities

The board is responsible for supervising management and the activities of First West. The board, either directly or through its committees, is responsible for:

- Understanding and establishing prudent risk management policies for significant risks to which First West is exposed
- Annually articulating and communicating First West's overall risk appetite to management
- Annually reviewing and approving the Enterprise Risk Management framework and other related risk policies
- Gaining assurance that First West has an effective and functional risk management process in place
- Monitoring the level of risk and controls through reports from management and others (for example internal auditors, external auditors or regulators), making inquiries and determining if risk levels are appropriate
- Gaining assurance First West has implemented the board-approved risk appetite and has established and is monitoring appropriate risk tolerances

RISK MANAGEMENT FRAMEWORK

The objective of First West's enterprise risk management framework is to enhance value and preserve the long-term, sound business and financial operations of the credit union. First West's enterprise risk management is guided by the credit union's board of directors and administered by the risk services department of the credit union.

The eight categories of significant risks affecting First West are:

- Strategic
- Operational
- Credit
- Financial
- Market
- Liquidity, funding and counterparty
- Legal and regulatory
- Information technology

Each risk category has an established risk profile to assess risk levels and their related trends and is reported to the board on a quarterly basis. This framework includes appropriate tolerances, risk reporting, and board and management risk policies to effectively manage and monitor risk.

Significant risks affecting the credit union are monitored, assessed and managed by management, with oversight provided by the executive risk committee and risk positions reported to the board on a quarterly basis. Areas of significant risk are subject to internal, external and regulatory audits.

Strategic Risk

Strategic risk includes risks related to business strategy execution, the credit union system, business continuity (or disruption) and the external environment in which the credit union operates. Strategic risk arises from an institution's inability to implement appropriate business strategies and/or the inability to adapt to changes in its business or economic environment.

Operational Risk

Operational risk includes people, process, reporting and outsourcing risks.

Operational risk is inherent in all business activities. It is the risk of loss or missed opportunity resulting from inadequate or failed activities with regard to internal processes, systems and projects, human error, or external partners or vendors. This risk may impact our earnings, reputation, competitive position or result in regulatory penalties.

Fraud is an additional operational risk faced by all financial institutions. Fraud is an ever-evolving issue in the financial services industry and although it is impossible to prevent all fraud, we have rigorous controls, procedures and advanced security measures in place to safeguard the funds that our members entrust to us. To better protect our members from fraud, we have implemented a comprehensive cyber-security strategy and expanded our cyber-security team.

Strategies employed to manage operational risk include:

- Establishing standards of professional conduct
- Implementing policies and procedural controls
- Reviewing internal control effectiveness and strengthening areas where needed
- Initiating employee training programs
- Managing property, liability and financial bond insurance programs to provide additional protection from loss
- Establishing a process for employees to confidentially report suspicious activities
- Establishing a process to monitor, prevent and detect suspicious transactions, including a team of specialists dedicated to preventing fraud and managing compliance to legislative requirements
- Maintaining regular audits for compliance and effectiveness of controls by independent internal and external audit teams, which provide senior management and the audit and risk management committee with recommendations to improve internal controls
- Issuing quarterly risk reports to the board

Credit Risk

Credit risk is the risk that a financial loss will be incurred due to the failure of a party or counterparty to discharge its contractual commitment or obligation to the credit union. Credit risk arises principally in lending activities that result in loans to members, but also from interest rate swaps (derivatives).

Please refer to Note 5b of the consolidated financial statements for more information on credit risk.

Financial Risk

Financial risk results from insufficient income to provide the necessary support to operations, strategic initiatives or unanticipated losses. Financial risk is continuously monitored. Specifically, consolidated financial statements showing actual results are analyzed by management against budgets and key performance metrics (KPIs). Each quarter, forecasts are made to year-end based on actual results year-to-date, and plans for the remainder of the year and variances to budget are analyzed by management and reported to the board.

Market Risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in interest rates. Interest rate risk arises when the values of assets and liabilities do not change by the same amount when interest rates change. Where portfolios are matched in terms of maturities, interest rate risk is reduced. This category also includes yield curve risk, basis risk and optionality risk. Market risk also incorporates price risk and foreign exchange risk.

Please refer to Note 5d of the consolidated financial statements for more information on market risk.

Liquidity, Funding and Counterparty Risk

Liquidity and funding risk is the risk that insufficient access to or inappropriate management of funds and capital threatens the credit union's capacity to grow. The exposure to loss as a result of a poor investment or the inability to satisfy cash flow obligations in a timely and cost-effective manner impacts our ability to achieve our business objectives. Counterparty risk is the risk of loss originating from a counterparty failing to meet their obligation in accordance with contractual terms or a decrease in the value of the assets due to a decrease in the credit quality of the counterparty guarantor or the assets (collateral) supporting the counterparty exposure.

The liquidity and funding policy of the credit union addresses liquidity and funding risks on both an operational and strategic level. The desired liquidity level above the statutory requirement is determined by taking into account the balance between the cost of liquidity and the yield achieved. Contingency liquidity is managed by having a plan in place that can be invoked quickly and provides access to a diverse range of funding sources when needed.

The credit union at all times maintains statutory liquidity levels as required by regulations. Statutory liquidity deposits must be held with Central 1 Credit Union according to the credit union's deposit-loan agreement. The statutory liquidity ratio is 8.0% of deposits and borrowings as at the reporting date. Based on total deposits and borrowings as at December 31, 2017, our liquidity portfolio exceeded the minimum requirements by $325.2 million.

Please refer to Note 5c of the consolidated financial statements for more information on liquidity risk.

First West will only enter into derivative or credit facilities with Central 1 Credit Union or other counterparties that have a minimum DBRS rating of R-1 (middle) or the equivalent.

Legal and Regulatory Risk

Legal and regulatory risk is the risk of negative impact to our earnings or reputation as a result of failure to comply with or adapt to legal and regulatory requirements, industry practices or ethical standards. Our operations are governed by various acts and regulations, and we are expected to meet a high standard in business dealings and transactions.

Information Technology Risk

Information technology risk includes infrastructure, project, disaster recovery, information, operational and cyber risks. It includes the risk that confidentiality, integrity and availability of information is not maintained and is inclusive of both internal and external threats.

First West takes seriously its responsibility to ensure our systems are secure, available, have high integrity and continue to meet members' needs. To ensure our systems remain current and robust, significant investments are made each year in infrastructure technologies and cyber security resources. First West employs rigorous monitoring activities, testing procedures and plans for disaster recovery and business continuity with our technology systems and data.

PRIVACY POLICY

First West Credit Union is committed to ensuring the confidentiality, privacy and protection of the personal information of all members and other individuals whose personal information is held or controlled by the credit union.

The credit union has a designated chief privacy officer to oversee the protection of personal information in compliance with the BC Financial Institutions Act, the BC Personal Information Act, and the credit union's privacy policies and practices.

SUSPICIOUS TRANSACTION REPORTING

First West is committed to preventing the proceeds of crime being laundered through the credit union, including tax evasion or terrorist financing activities.

The credit union has a designated chief anti-money laundering officer (CAMLO) who oversees the organization's anti-money laundering and terrorist financing control framework. In addition, the CAMLO ensures compliance with:

- The federal Proceeds of Crime Money Laundering and Terrorist Financing Act
- The credit union's anti-money laundering policy

Suspicious transactions and potential tax evasion are reported to the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC). This is a legislated requirement for all financial institutions in Canada.

WHISTLEBLOWER POLICY

The board of directors together with management is committed to maintaining a healthy work environment at First West that is free of workplace harassament and that empowers employees to report any suspected wrongdoing or employee misconducts without fear of recrimination. Our whistleblower policy encourages and enables employees to raise concerns. First West is proud of its reputation and our whistleblower policy ensures that all reported incidents or suspected wrongdoings are investigated.