FIRST WEST CREDIT UNION **2018 ANNUAL REPORT**

Risk Report

Management's Discussion & Analysis

FIRSTWEST
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.

OBJECTIVES & PRINCIPLES

OBJECTIVES

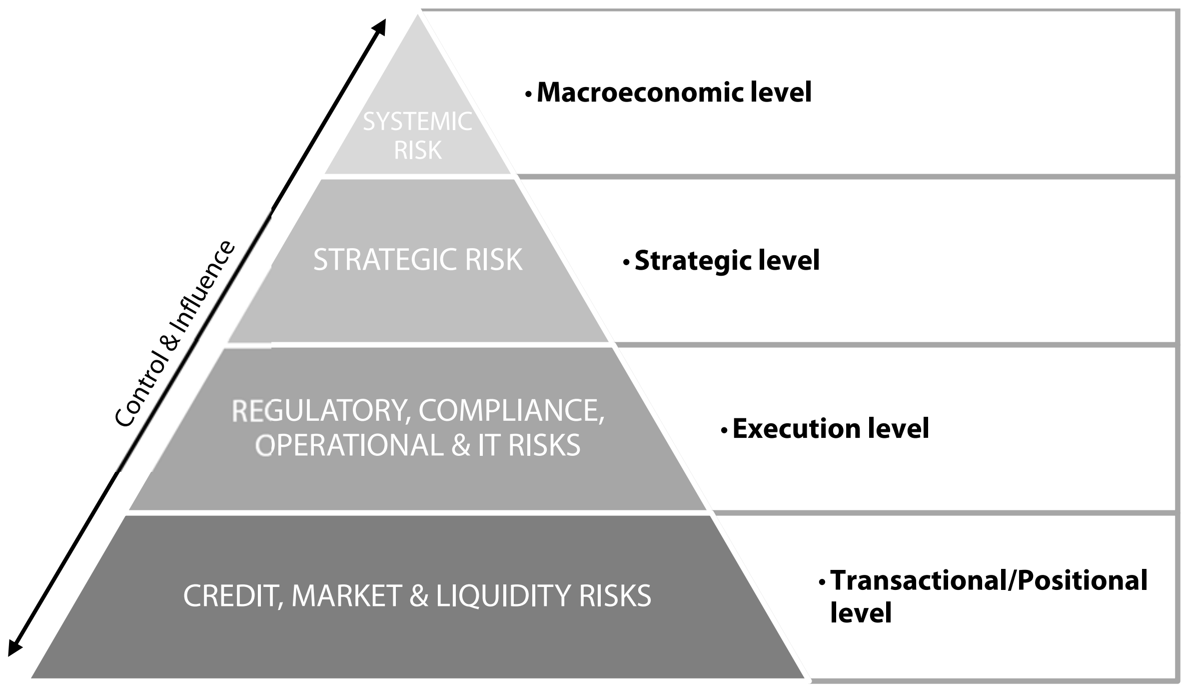
- Ensure all risk-taking activities and risk exposures are within the board-approved risk appetite, risk limits and corresponding capital and liquidity needs
- Maintain and ensure continued enhancement of the Enterprise Risk Management Framework and practices
- Provide independent and objective oversight of the management of risks arising from our operations and, when necessary, challenge decisions that give rise to material risks
- Maintain an effective enterprise-wide risk management process through working in partnership with all areas of First West
- Ensure continuous improvement in risk management processes and practices

RISK MANAGEMENT PRINCIPLES

- Create value
- Be an integral part of organizational processes
- Be part of decision making process
- Explicitly address uncertainty and assumptions
- Be a systematic and structured process
- Be based on the best available information
- Take human factors into account
- Be transparent and inclusive, dynamic, iterative and responsive to change
- Be capable of continual improvement and enhancement

Risk Pyramid

Our risk pyramid identifies the principal risks First West faces and provides a common language and discipline for the identification and assessment of such risks in existing businesses, new businesses, products, initiatives, acquisitions and alliances.



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 policies
- 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 to
- 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 department that is led by the senior vice-president, risk. The SVP Risk reports to the CEO and to the risk, investment and loan 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 risk, investment and loan 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. Employees are accountable for achieving the best results for their 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 statement (RAS) 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 sustainable 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.

RISK APPETITE STATEMENTS

The risk appetite atatement (RAS) defines the type and maximum comfortable amount of risk within our risk capacity that First West is willing to assume in pursuit of organizational objectives. The RAS comprises a description of risks First West generally prefers and the ones it generally avoids. We use the RAS as a foundation to define the aggregate level of risk First West may assume across multiple metrics.

QUALITATIVE STATEMENTS

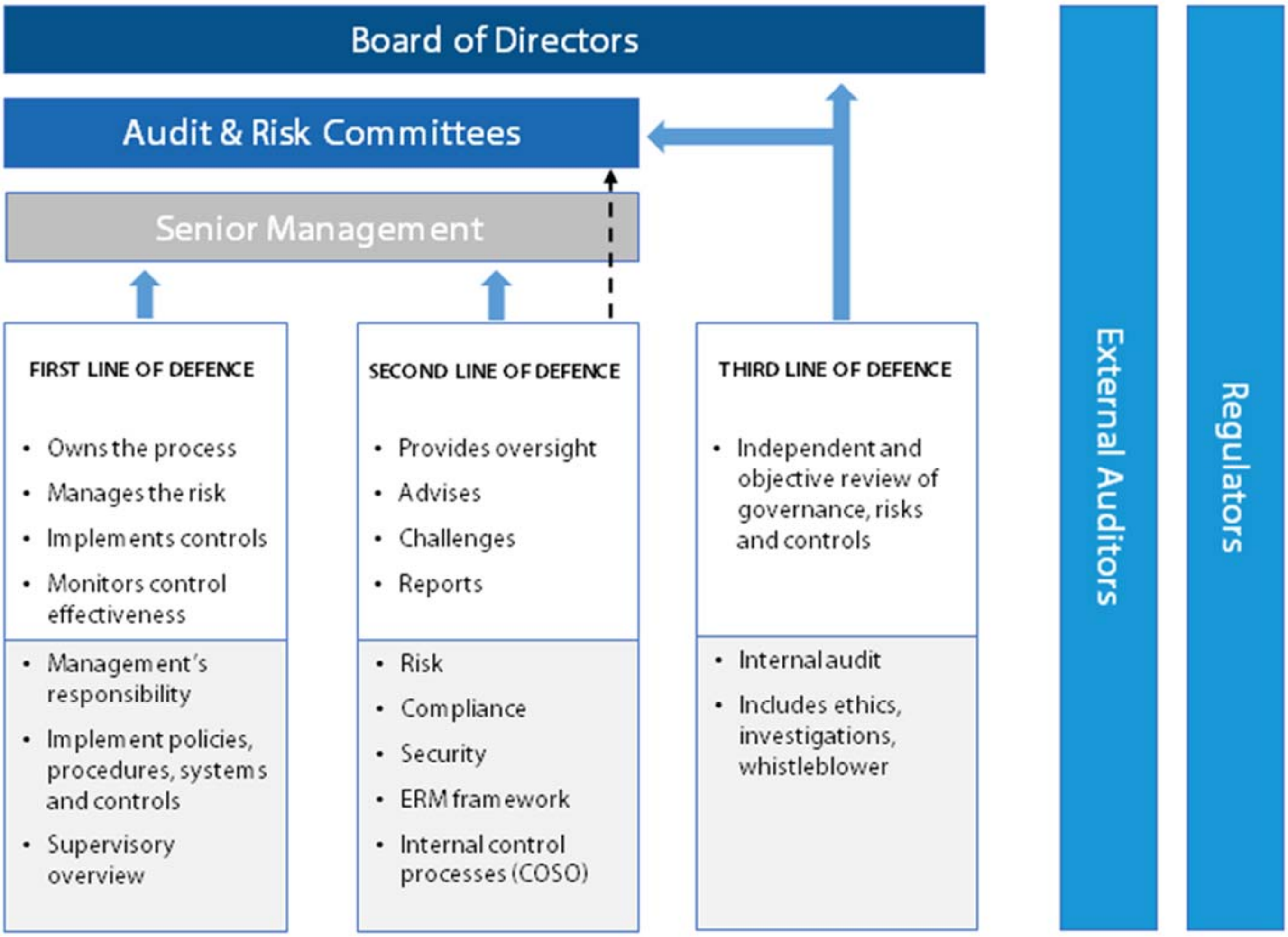
- Manage risk exposures in line with board approved risk appetite
- Manage earnings volatility and exposure to future losses under normal and stressed conditions
- Avoid excessive concentrations of risk
- Ensure sound management of operational and regulatory compliance risk
- Ensure capital adequacy and sound management of market, liquidity and funding risk
- Maintain strong credit risk profile and prudently manage credit risk

QUANTITATIVE STATEMENTS

- Undertake only risks we understand; Make thoughtful and future-focused risk decisions
- Effectively balance risk and reward to enable sustainable growth
- Maintain a healthy and robust control environment to protect First West and our members
- Always uphold our purpose and vision and consistently abide by our values, reputation and the trust of our members and communities
- Always be operationally prepared and financially resilient for a potential crisis

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 continuous improvement of risk management 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 six categories of significant risks affecting First West are:

- Strategic
- Operational
- Credit and counterparty
- Liquidity and market
- 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 inability to implement appropriate business strategies or the inability to adapt to changes in its business or economic environment, or both.

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 cybersecurity 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 & Counterparty 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 6b of the consolidated financial statements for more information on credit risk.

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 6d of the consolidated financial statements for more information on market risk.

Liquidity and Funding Market 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.

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. First West has created a liquidity contingency plan (LCP) which establishes strategies for addressing liquidity shortfalls. Preparation includes an early warning system, contingent funding resources, a response plan identifying roles and responsibilities, creation of a crisis management team, and regular testing and review of the plan to ensure that it is operationally sound. Although the credit union has not experienced a significant outflow of client deposits during periods of credit or liquidity stress, this possibility must be considered in the plan. The credit union recognizes liquidity events are unexpected and various conditions can lead to increasing liquidity risk and emergency shortfall situations. This threat reinforces the importance of prudent management guidelines for normal market conditions and for highly stressful market developments. The LCP serves as a formal plan that proactively addresses any emerging funding crisis.

First West's LCP follows required guidelines within the following sections:

- Management of a range of stress environments: describes management's execution of an action plan under a contingent event
- Strategies for addressing liquidity shortfalls: describes funding sources and how these may be impacted to boost liquidity levels
- Liquidity event management process: describes the model framework which ensures that liquidity risk is addressed; for example, this framework includes clear lines of responsibilities, escalation procedures and testing for operational soundness (the framework ensures testing processes are flexible and routinely updated)
- Monitoring framework for contingency events: describes how the credit union has developed a dashboard of early warning indicators
- Internal controls include how the third-party audit process ensures an operationally sound plan

First West monitors a number of early warning indicators to provide a cushion of time to use less invasive remedial actions to prevent the breach of any of the LCP triggers. The management threshold for total liquidity coverage is set at 10%. Failure to maintain Total Liquidity Ratio > 10% within will result in immediate activation of the LCP. Based on total deposits and borrowings as at December 31, 2018, our total liquidity ratio was 10.6%, exceeding our threshold by $397.3 million.

Refer to Note 6c 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 cybersecurity 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 and management is committed to maintaining a healthy work environment that is free of workplace harassament and 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.