Management's Discussion and Analysis

The Management's Discussion and Analysis (MD&A) section of the Annual Report provides an overview of Coast Capital's operations and financial position. The MD&A also includes a discussion on risk management and an analysis of our capital structure. The information provided demonstrates our commitment to balancing strong financial performance with the delivery of exceptional value to our members. Our decision-making model takes both into account so that we can continue to improve the financial well-being of our members while supporting the communities in which we work and live.

This section is current as of February 26, 2018, and should be read with the audited consolidated financial statements, which are prepared according to the International Financial Reporting Standards (IFRS).

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About Forward-Looking Statements

This Annual Report contains forward-looking statements about our operations, goals, and expected financial performance. These statements are subject to risks and uncertainties that may affect results, including changes in the legislative or regulatory environment, interest rates, and general economic conditions in B.C. and Canada (among others). Readers should give careful consideration to these issues and not rely too heavily on our forward-looking statements.

Management's Discussion and Analysis

Economic Environment in 2017

Despite heightened international political uncertainty, global economic growth accelerated in 2017. The global backdrop included U.S. policy changes related to immigration, taxes, and trade agreements; the beginning of Brexit negotiations between the U.K. and the European Union; and North Korean missile testing. Although economic growth was solid and labour markets tightened during the year, inflation remained surprisingly muted in most developed countries. As a result, interest rate increases were modest, and rates remained at generally low levels. Global equity markets responded favourably to these economic conditions, illustrated by the relatively stable upward price trends of major market indices.

In the U.S., real gross domestic product (GDP) growth accelerated to 2.3% in 2017, up from 1.5% in 2016. The upswing is attributed to increased business investment and continued strong consumer spending, with consumer confidence supported by healthy employment levels, rising wages, and wealth impacts through asset value increases.

After lacklustre GDP growth of 1.4% in 2016, the Canadian economy started 2017 extremely strong, posting an annualized GDP growth rate of 4.0% in the first half of the year. The pace of growth slowed in the second half to 1.8%, resulting in an impressive overall growth rate of 2.9% in 2017, placing Canada top among G-7 countries in terms of real GDP growth. Canada's primary economic drivers in 2017 were consumer spending, underpinned by strong employment and wage growth, and housing market activity. However, Canadian household debt levels continued to rise in 2017, placing Canada among the top developed countries in terms of household debt as a percentage of GDP.

In response to the rapid economic growth experienced early in the year, the Bank of Canada raised its benchmark overnight interest rate twice in Q3, by 0.25% each time. Including these increases, the Bank of Canada rate closed the year at 1.0%, which remains at a relatively low rate. Further rate increases during the remainder of the year were put on hold due to concerns over the prospect of NAFTA renegotiation and continued low inflation rates. The value of the Canadian dollar appreciated against the U.S. dollar during 2017, but remained relatively low, finishing the year near $0.80.

Wildfires were a prominent part of the news in B.C. through the summer months and disrupted economic activity in some areas of the province. However, B.C. continued its impressive multi-year economic growth trend in 2017, posting a real GDP growth rate of 3.2%, ranking B.C. second only to Alberta in terms of provincial growth rates. Stellar employment growth pushed the B.C. unemployment rate to a nine-year low of 4.8% at the end of 2017. Favourable job prospects and low interest rates bolstered consumer confidence and spending during the year, while the low Canadian dollar stimulated growth in goods exports and tourism. Government spending on utility, transportation, and public works projects also provided an economic boost in 2017, as did business investment. Regulation and policy changes designed to constrain housing market demand did little to diminish momentum within B.C.'s housing market in 2017. Although housing sales declined by 4.0% in 2017 relative to 2016, they remained at historically high levels. Strong demand resulted in higher house prices, which increased by 7.5% in 2017.

Impact on Us

Continued strong housing market activity in 2017 translated into strong growth in our residential mortgage and commercial construction mortgage portfolios. Interest rate increases removed some of the pressure on compressed interest rates spreads and, combined with higher loan volumes, increased the net interest income generated from our lending and deposit activities. Continued low interest rates and low unemployment assisted in maintaining a benign credit environment, which assisted in keeping delinquency rates low, and reduced loan loss provisioning requirements on our loan portfolio.

For our members, the continuation of a relatively low interest rate environment had mixed impacts. Existing homeowners benefited from low mortgage rates and enjoyed favourable wealth impacts through rising property values. For first-time homebuyers, however, low interest rates helped fuel a seller's market along with higher home prices. Depositors also continued to be challenged by low returns and, while healthy consumer spending provided a boost to the economy, rising personal debt levels increased member sensitivity to possible future interest rate increases.

Economic Outlook for 2018

While many of the elements contributing to global and economic uncertainty in 2017 will continue into 2018, there is also an expectation that global economic growth momentum from 2017 will continue into 2018. In the U.S., real GDP is expected to rise to from 2.3% in 2017 to 2.6% in 2018, with a boost from tax reform measures at the close of 2017 and continuing low unemployment. The Federal Reserve is expected to increase interest rates gradually through 2018. The U.K. and Euro-area are expected to experience generally favourable growth, hampered somewhat by ongoing Brexit trade negotiations.

The forecast for Canada in 2018 is for solid but slower growth of 1.9%, compared to 2.9% in 2017. Housing market activity is expected to be moderated by rising interest rates, elevated levels of consumer debt, and housing policy changes. Government spending, on both federal and provincial infrastructure projects, and stronger business investment are expected to take up some of the slack in 2018. Exports, including to the U.S., look favourable in 2018, subject to NAFTA developments. While questions related to the future of NAFTA present a risk to economic growth, it is possible that even if negotiations are unsuccessful, withdrawal notice periods and court challenges may result in trade continuing relatively unhindered through 2018, with possible negative impacts felt most in subsequent years.

Canada's continued healthy economic growth in 2018 along with low unemployment is expected to produce gradual upward pressure on inflation. As a result, the benchmark Bank of Canada overnight rate, which rose to 1.0% at the end of 2017, is forecast to increase to 1.75% or 2.00% by end of 2018. The first increase of 0.25%, to 1.25%, was experienced in January 2018. The value of the Canadian dollar relative to the U.S. dollar in 2018 is expected to trend at levels similar to 2017, with forecasted U.S. Federal Reserve interest rate increases expected to be similar to the Bank of Canada rate increases during the year.

The outlook for B.C.'s economy in 2018 remains favourable, if not quite as robust as 2017. Overall real GDP growth is forecast at 2.2%, down from 3.2% in 2017. Rising interest rates and more stringent mortgage rules are expected to cool the housing market. Home prices may continue to rise in 2018, but at a slower pace than experienced in recent years. Higher interest rates combined with rising personal debt levels will also slow consumer spending. These impacts will be tempered by a continuation of B.C.'s low unemployment rate, forecast to be among the lowest in Canada at 5.0% in 2018. Despite uncertainty related to NAFTA and the lingering softwood lumber dispute with the U.S., surveys indicate that small business owners in B.C. are optimistic when looking forward to 2018.

Impact on Us

While higher interest rates may slow the growth of our mortgage assets, they may also provide a welcome boost to net interest margins after several years of compressed spreads, and result in higher net interest income. For our members, higher rates will have mixed impacts. For those seeking to enter the housing market, higher rates without price adjustments will further reduce the affordability of home ownership. Members with existing mortgages and other debt may see more of their income allocated towards debt servicing costs. For members seeking to grow their savings or who depend on deposits for income, however, the increase in interest rates will be welcomed. For all of our members, the financial help we provide will likely rise in terms of both importance and value.

Financial Performance

Financial Highlights of 2017

Year ended December 31 in thousands of dollars	2017	2016	Change from 2016 $	%
Net interest income	318,494	280,049	38,445	13.7
Fee, commission and other income	88,101	78,934	9,167	11.6
Total revenue	406,595	358,983	47,612	13.3
Provisions for credit losses	8,331	10,733	(2,402)	(22.4)
Non–interest expenses	309,432	275,367	34,065	12.4
Income before provision for income taxes	88,832	72,883	15,949	21.9
Provision for income taxes	13,055	14,357	(1,302)	(9.1)
Net income	**75,777**	**58,526**	**17,251**	**29.5**

Assets				
Cash and financial investments	2,093,685	1,934,312	159,373	8.2
Loans	14,788,882	12,858,372	1,930,510	15.0
Premises and equipment, other	165,943	176,534	(10,591)	(6.0)
Total Assets	**17,048,510**	**14,969,218**	**2,079,292**	**13.9**
Liabilities				
Deposits	14,366,432	12,960,818	1,405,614	10.8
Borrowings	1,437,485	869,138	568,347	65.4
Other liabilities	132,743	96,085	36,658	38.2
Total liabilities	15,936,660	13,926,041	2,010,619	14.4
Members' equity	1,111,850	1,043,177	68,673	6.6
	17,048,510	**14,969,218**	**2,079,292**	**13.9**

	2017	2016	Change from 2016 Basis points increase/(decrease)
Operating efficiency ratio	76.10%	76.71%	(61)
Total liquidity ratio	14.07%	14.48%	(41)
Capital ratio	14.69%	15.58%	(89)

While our performance is based on more than just our financial results, sound financial results are fundamental to our ability to continually improve the services we offer and the experience we deliver to our members. Maintaining a strong financial position also supports our ability to meet our employee commitments and to contribute to the communities in which we operate.

Several favourable results contributed to our overall strong core operating performance in 2017, summarized by our pre-tax income result of $88.8 million for the year, a 21.9% increase over 2016. Total revenue from operations, before provisions for credit losses, increased by $47.6 million, or 13.3%, compared to 2016. Revenue growth was strong in both net interest activities and other income. While non-interest expenses also increased by $34.1 million during the year, the rate of increase at 12.4% was lower than that of revenue growth. Additionally, credit provisioning expenses were slightly lower on a year-over-year basis, despite growth of our loan assets, reflecting benign credit conditions and risk management efforts.

Net interest income growth at 13.7% for the year was driven by both strong asset growth and improved net interest margins. Two prime rate increases, spawned by Bank of Canada rate increases, supported an improvement in our net interest margin, which increased from 1.96% in 2016 to 2.01% in 2017. Taking advantage of the robust housing market, we grew our loan assets by $1.9 billion, or 15.0%, during the year. Fee, commission, and other income growth of $9.2 million, 11.6%, year over year reflects increases in many areas, including banking services fees, wealth management commissions, credit card commissions, and foreign exchange activities. A Central 1-initiated redemption of Class E shares that we hold generated a $2.4 million gain, which also contributed to our other income result in 2017.

Non-interest expense growth of $34.1 million in 2017, while lower than revenue growth in both dollar value and percentage terms, had a notable impact on our overall financial performance. Several factors contributed to our expense growth in 2017. These included maintaining our commitment to community support through investing 7.0% of our budgeted pre-tax income, or $5.6 million, into local programs and events, and our commitments to staff in terms of wages and incentives. The rollout of new member services, development activities related to future service enhancements, and costs related to our federal credit union initiative also added to our 2017 expenses. Although our expenses increased on a year-over-year basis in 2017, the rate of expense growth at 12.4% was lower than our rate of revenue growth at 13.3% for the year. As a result, our operating efficiency ratio, which is a measure of expense efficiency, improved to 76.1%, a decrease of 61 basis points compared to 76.7% in 2016.

Our loan growth performance in 2017 was our highest single-year result on record at $1.9 billion or 15.0%. Our deposit growth, while also very strong at $1.4 billion, or 10.8%, was outpaced by our loan growth. This resulted in an increased use of borrowing to support our asset growth. Our exceptional loan growth performance also had knock-on impacts on our capital and liquidity ratios. Although these ratios declined in 2017, both ratios remained strong. Our total liquidity ratio, which basically measures liquid cash and investment assets against deposit liabilities, decreased by 41 basis points to 14.1% at the end of 2017, from 14.5% at the end of 2016. Our capital ratio, which measures capital against risk-weighted assets, decreased by 89 basis points to 14.7% at the end of 2017, compared to 15.6% at the end of 2016.

Business Line Performance

Retail

Through our branch network, Contact Centre, and digital platform, the retail division welcomed almost 21,000 new members in 2017 and delivered over 24,000 Where You're At Money Chats to our members. The Money Chat service provides members with a snapshot of their overall personal or business financial health, and identifies ways we can help to improve it. In addition to our unique service proposition, strong retail growth results in 2017 were assisted by additional production through two new branches, located in Courtenay and Kelowna, both opened in Q4 of 2016. Innovative service features launched in 2017 also contributed to our growth results. These include Interac Flash (debit card pay-by-tap), Apple Pay (the first credit union in Canada to enable members to pay using an iPhone, iPad, or Apple Watch), and digital membership account opening (new members can now join Coast Capital Savings in as few as five minutes, from anywhere they choose). 2017 also saw our Contact Centre service expanded to include Sunday hours.

We grew our retail loan assets (excluding leases) by a record $1.3 billion, over 14.3%, in 2017, reaching a new portfolio milestone of almost $10.5 billion. Mortgages make up the majority of our retail loan portfolio. Mortgage growth results in 2017 were supported by our Members Get It® Mortgages offer, which includes Help Extras of up to $1,000 to members who obtain or renew their mortgages with us. In 2017 we funded almost $6 million in Help Extras paid to members in the form of deposits or investments aligned to their personal financial goals.

Retail deposits grew by $342 million in 2017, or 4.6%, to $7.9 billion. Slower growth of retail deposits against much stronger growth of loan assets created added dependence on other funding channels, including agency deposits, institutional deposits, and borrowing. The need to expand the use of higher-cost funding channels constrained our ability to increase our net interest margin.

Management's Discussion and Analysis

While not included as assets in our consolidated financial statements, our mutual and segregated fund assets under administration grew by $487 million in 2017, or 14.2%, to over $3.9 billion. Over half of the growth generated in 2017 occurred in our co-branded Low-fee, More-for-me Mutual Funds® offer. Mutual and segregated fund asset growth performance in 2017 was supported by generally favourable capital markets and by the sales and advice efforts of our staff licensed to sell these products.

Looking ahead to 2018, we plan to offer new digital tools that will provide members with value-added insights into their financial activities and empower them to take control of their finances. We expect strong loan growth to continue in 2018, although at a reduced rate compared to the growth experienced in 2017. Moderated loan growth will allow us to place more emphasis on helping our members save, which we expect will translate into stronger retail deposit growth, compared to 2017.

Commercial and Leasing

Our commercial banking division is an important part of our business operations, creating opportunity for enhanced financial performance and supporting our long-term financial stability. Offering financial services that help local businesses succeed is also strongly aligned with our community focus.

Commercial members account for a significant part of our total loan and lease assets. Backed by sound underwriting policies and practices, the commercial loan and lease portfolio provides diversification to assist in managing our overall portfolio risk, while also giving us access to higher yields on assets that strengthen our financial performance. Our commercial members also provide an important source of core funding through business deposit accounts, and generate additional revenue through the various banking services they require.

In 2017, the commercial division welcomed almost 3,000 new members, bringing the total commercial member count to a new milestone of over 50,000 at the end of the year. Our total commercial loan and lease assets grew by $617 million in 2017, or 16.6%, to $4.3 billion at the end of the year. The majority of our commercial asset growth in 2017 was driven by variable rate financing for multi-family development projects, reflecting the strong demand for residential real estate in 2017. We continue to focus on deposit growth opportunities in the commercial market. As a result of these efforts, in 2017 we increased our commercial deposit balances by $377 million, or 15.5%.

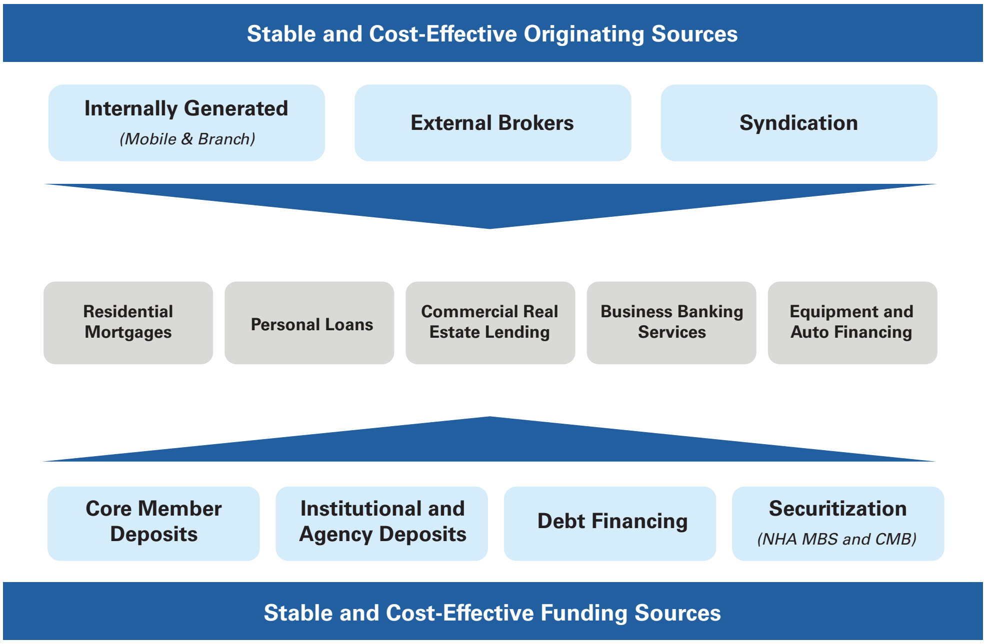
Supporting our commercial banking results in 2017 were several initiatives rolled out during the year designed to enhance the services available to commercial members, improve our commercial member banking experience, and attract new commercial members. These included the creation of a new dedicated business banking team at our Contact Centre, the addition of a mezzanine financing option, and campaigns with incentives for new commercial banking memberships. Additionally, the number of commercial members using our enhanced small businesses online banking platform, which was launched at the end of 2016, grew to over 17,000 by the end of 2017.

In 2018 we will be deepening our commitment to meeting the needs of our commercial members. At the end of 2017 we created a new vice-president of small business position to oversee our small business operations. We also plan to offer new digital tools to our commercial members that will provide them with value-added insights into their financial activities, and expand their digital transaction options. Similar to the digital membership opening capability made available to retail members in 2017, in 2018 we plan to make digital membership opening available to new small business members. We expect to experience continued strong growth in our commercial operations in 2018, although somewhat moderated compared to the growth results produced in 2017.

Net Interest Income

Net interest income is the difference between the interest earned on loans and other financial assets, and the interest paid on deposits and other funding sources. It is impacted by both the size of our balance sheet and the net interest rate margin earned (net interest margin is the net interest income we earn as a percentage of the average total assets). The interest rates we offer on loans and deposits are managed throughout the year to ensure members have access to rates that are both fair and competitive.

We maintain a diversified portfolio of loan assets, in terms of both type and source, that are supported by the various funding options we have established. The multiple business lines and channels included in our structure provide diversification and balance, allowing us to grow in a stable and sustainable manner.



Our 2017 net interest income of $318.5 million was $38.4 million, or 13.7% higher than in 2016. This increase is attributed to both strong balance sheet growth and increases in our net interest margin. Average asset balances in 2017 were $1.5 billion, or 10.5% higher than in 2016. Our net interest margin in 2017 was 2.01%, up 5 basis points from 1.96% in 2016. Two Bank of Canada rate increases in Q3 of 2017, totalling 50 basis points, helped to support our net interest margin increase.

Net Interest Margin

In general terms, net interest margin represents the difference between interest earned on assets and interest paid on deposits and other funding sources as a percentage of average total assets. Interest rate margin compression, due to historically low interest rates and a flat yield curve, has been a challenge across the industry for several years. In 2017 we experienced a modest improvement in our net interest margin, which increased by 5 basis points to 2.01%. This increase is primarily related to reductions in our funding costs, while the yield on our average assets remained relatively flat year over year.

Despite two Bank of Canada rate increases in Q3, matched by prime lending rate increases, the yield on our total loans declined by 4 basis points to 3.28% in 2017, down from 3.32% in 2016. During the first half of 2017 the yield earned on our loans declined, continuing the downward trend experienced in 2016, as new and maturing loans were priced at lower rates. Interest rate increases in Q3 had a favourable impact on the yields earned on variable rate loans. These yield gains, however, were tempered by continued downward pressure on fixed rate loan yields as maturing fixed rate loans repriced at rates lower than those that applied prior to their maturity. Potential yield enhancements from a slight increase in our commercial and personal loan portfolios as a percentage of our total loans were offset by reductions in the yields earned on these portfolios. An increase in the rates earned on our cash and financial instrument assets, from 1.18% in 2016 to 1.36% in 2017, helped improve our interest rate earned on our total assets to 3.01%, a 1 basis point increase over 2016.

Our overall funding cost as a percentage of total assets decreased by approximately 4 basis points, from 1.04% in 2016 to 1.00% in 2017, driving the majority of our net margin increase. Rates paid on deposits and other funding sources were impacted in several ways during 2017, resulting in an overall reduction in our funding costs as a percentage of total assets. Interest rates across funding sources continued to decline through the first half of 2017 before changing course following the Bank of Canada rate increases in Q3. Additionally, during 2017 our deposit portfolio made a further shift towards lower rate demand account balances. This last impact was a response to the continuing low interest rate environment, which offered members only modest rate premiums for accepting the conditions of longer–term deposit options. Offsetting these favourable funding cost impacts, in 2017 our core deposits from retail and commercial operations as a percentage of total deposits decreased from approximately 77% to 74% during the year. This shift increased our dependency on higher-cost agency and institutional deposits. We also increased our borrowings during the year, both in dollar amount and as a percentage of total liabilities, to meet our asset growth funding requirements. On average, rates paid on borrowings are higher than those paid on deposits.

Net Interest Income

Year ended December 31 in thousands of dollars				2017				2016
	Average balance	Mix %	Interest	Interest rate %	Average balance	Mix %	Interest	Interest rate %
Cash resources	1,910,011	12.0	25,915	1.36	1,922,162	13.6	22,701	1.18
Loans								
Residential	9,569,275	60.6	277,784	2.90	8,543,674	59.7	249,471	2.92
Commercial	3,852,158	24.4	152,184	3.95	3,423,585	23.9	139,991	4.09
Personal	143,590	0.9	8,870	6.18	62,403	0.4	3,986	6.39
Lines of credit	161,017	1.0	11,482	7.13	170,920	1.2	12,157	7.11
Total loans	726,040	86.9	450,320	3.28	12,200,582	85.2	405,605	3.32
Other Assets	165,943	1.1	–	13	176,533	1.2	–	–
Derivatives	–	–	34	–	–	–	365	–
Total	15,801,994	100.0	476,269	3.01	14,299,277	100.0	428,671	3.00
Deposits								
Demand	6,287,340	39.8	21,682	0.34	5,835,304	40.8	23,277	0.40
Term	5,605,874	35.5	100,019	1.78	5,061,482	35.4	93,729	1.85
Registered plans	1,307,493	8.3	16,137	1.23	1,348,185	9.4	18,689	1.39
Total deposits	13,200,707	83.6	137,838	1.04	12,244,971	85.6	135,695	1.11
Borrowings	1,276,885	8.1	19,937	1.56	785,259	5.5	12,927	1.65
Total financial liabilities	14,477,592	91.6	157,775	1.09	13,030,230	91.1	148,622	1.14
Other Liabilities	256,622	1.6	–	–	249,672	1.7	–	–
Class B Shares	29,311	0.2	–	–	31,121	0.2	–	–
Accumulated other comprehensive income (AOCI)	(1,927)	–	–	–	8,910	0.1	–	–
Retained Earnings	1,040,396	6.6	–	–	979,344	6.8	–	–
Total	15,801,994	100.0	157,775	1.00	14,299,277	100.0	148,622	1.04
Net interest income			318,494	2.01			280,049	1.96

Changes in net interest income

Our net interest income increase of $38.4 million in 2017 is attributed to both growth and rate impacts. Approximately $29.4 million, or 77%, of the increase was due to growth, with the remaining $9.0 million, or 23%, attributed to favourable rate impacts.

	2017		
Year ended December 31	Increase (decrease) due to change in		
in thousands of dollars	**Average Balance**	**Average Rate**	**Net Change**
Total loans and cash resources	45,934	1,664	47,598
Total financial liabilities	(16,509)	7,356	(9,153)
Net interest income	29,425	9,020	38,445

Fee, Commission, and Other Income

In addition to loan and deposit activities that generate interest income, we provide our members with many products and services that produce fee and commission revenue. These include day-to-day banking services, credit cards, foreign exchange, and life insurance, as well as mutual and segregated fund investments. These services are important to members, helping to meet their diverse financial services needs while also providing income stability and diversification to our financial operations. The fees and commissions earned on the products and services we provide are regularly reviewed to ensure they provide our members with excellent value while ensuring market-competitive and fair returns on our cost of delivery.

In 2017, revenue from fees, commissions, and other income totalled $88.1 million, an increase of $9.2 million, or 11.6%, compared to 2016. All revenue subgroups experienced growth in 2017, with the exception of lending fees. The largest increase in dollars was generated from our investment and life insurance products activities. These include mutual funds, segregated funds, and a variety of life insurance products sold through our team of financial planners and insurance specialists. Mutual and segregated fund assets administered on behalf of our members grew by $487.0 million, or 14.2%, in 2017 to $3.9 billion. Over half of this growth is attributed to our co-branded Low-fee, More-for-me Mutual Funds. These funds, which were first launched in 2009, have grown to almost $1.9 billion, or 47.0% of our total fund assets, at the end of 2017.

Banking and payment services revenue includes many of the traditional service fees associated with day-to-day banking for both our retail and commercial members. These include account and transaction fees, safety deposit boxes, bank drafts, and wire transfer services. Despite our growing member base, this is a revenue area where growth prospects have become more limited, due both to competition and to shifting transaction preferences as our members continue to embrace new service options that increase convenience while reducing both the cost of delivery and the fees they pay. The $1.9 million, or 8.6%, revenue growth from these fees in 2017 is primarily attributed to new paper statement fees, which were implemented in Q2 of 2017 in conjunction with the launch of our new, no-charge eStatement service. The fee is only paid by members who choose to keep receiving monthly paper statements, and will likely decrease over time as more members move to the eStatement option.

Lending fee revenue decreased in 2017 by $0.2 million, or 2.6%, related to reduced creditor insurance volumes, notably related to slower personal loan portfolio growth, and also to slower production in our leasing business. Credit card commissions increased $0.7 million, or 9.7%, reflecting continued momentum in the expansion of our co-branded Desjardins Visa credit card offer. Foreign exchange revenue grew in 2017 by $0.2 million, or 6.6%. The 2017 result represents a reversal of the declining revenue trend for foreign exchange activities experienced over the previous three years. The low valuation of the Canadian dollar relative to the U.S. dollar in recent years, combined with increased local market competition for foreign exchange business, has put added pressure on both volume growth and exchange rate spreads. Other revenue increased by $2.2 million in 2017, favourably impacted by a one-time gain of $2.4 million resulting from a Central 1-initiated redemption of Class E shares that we hold.

Fee, commission and other income

Year ended December 31 in thousands of dollars	2017	2016	Change from 2016 $	%
Lending fees (includes creditor insurance)	8,731	8,964	(233)	–2.6%
Banking and payment services	23,997	22,092	1,905	8.6%
Investment and life insurance products	35,676	31,322	4,354	13.9%
Credit card revenues	7,500	6,839	661	9.7%
Foreign exchange	3,918	3,676	242	6.6%
Other	8,279	6,041	2,238	37.1%
Total	88,101	78,934	9,167	11.6%

Provision for Credit Losses

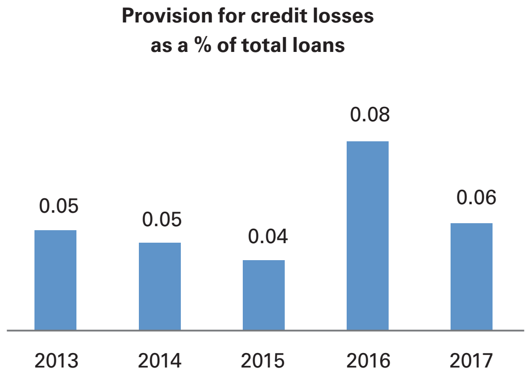
Our 2017 provision for credit losses was $8.3 million, $2.4 million lower than 2016. The decrease in 2017 is attributed to our specific provision amount, which was $4.1 million lower in 2017, while our collective provision was $1.8 million higher.

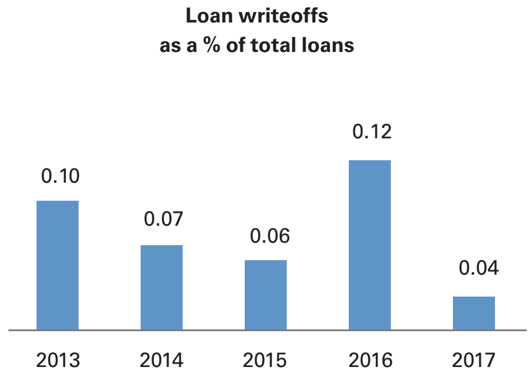
Our total allowance for credit losses increased to $35.2 million, a $2.7 million increase compared to $32.4 million at the end of 2016. Of the increase, approximately $1.0 million is attributed to our specific allowance and $1.8 million to our collective allowance. Given our very strong loan growth result in 2017, the total allowance as a percentage of our total loans decreased from 25 basis points to 24 basis points. Benign credit conditions and strong collateral values supported by rising real estate prices contributed to our favourable allowance result. These same conditions also assisted in reducing our loan writeoffs in 2017 compared to 2016, with additional impacts in comparing year-over-year writeoffs attributed to notable leasing portfolio writeoffs experienced in 2016.

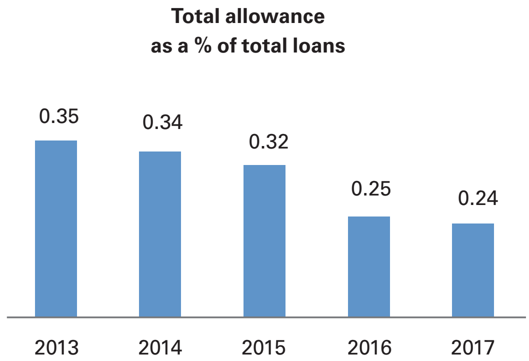
Asset quality coverage

As at December 31 in thousands of dollars	2017	2016
Total loans	14,788,882	12,858,372
Provision for credit losses	8,331	10,733
Loan writeoffs	6,560	16,068
Total allowance for credit losses	35,162	32,413
Impaired loans	13,716	21,279
Members' equity	1,111,850	1,043,177
in per cent		
Provision for credit losses as % of total loans	0.06	0.08
Loan writeoffs as % of total loans	0.04	0.12
Impaired as % of total loans	0.09	0.17
Impaired as % of members' equity	1.23	2.04
Total allowance as % of impaired loans	256.36	152.32
Total allowance as % of total loans	0.24	0.25

Management's Discussion and Analysis







Non-Interest Expenses

Non-interest expenses include all expenses that are not interest-related, excluding provisions for credit losses and income taxes. We strive to manage our operating costs in a diligent and efficient manner, while also recognizing the impacts of spending decisions on member service and long-term capital growth to support sustainability. Our 2017 non-interest expenses were $309.4 million, up $34.1 million, or 12.4%, compared to 2016. Although our expenses increased on a year-over-year basis in 2017, the rate of expense growth at 12.4% was lower than our rate of revenue growth at 13.3% for the year. As a result, our operating efficiency ratio, which is a measure of expense efficiency, improved to 76.1%, a decrease of 61 basis points compared to 76.7% in 2016.

Staff salaries and benefits accounted for the largest area of expense increase in 2017, up $20.6 million, or 14.6%, year over year. This increase reflects a 10.6% increase in our total staff count (measured on a full-time equivalency basis) during the year, as well as market salary increases and increases in variable and incentive pay. Notable areas of staffing growth in 2017 include our technology and transformation group, aligned to strategic and operational projects during the year, and our Contact Centre, related to the extension of service hours in 2017 to include Sundays.

Technology expenses also increased significantly, up $10.7 million, or 47.0%, year over year. Our higher technology costs reflect the improvements we have made to expand and enhance the services available to our members on digital platforms and through our Contact Centre. Depreciation expense accounted for the largest increase in our technology expenses. This increase is primarily the result of our assessments in 2017 to accelerate the depreciation schedule for certain software assets.

Professional services expenses at $12.0 million in 2017 were $2.9 million higher year over year. This increase reflects the work done during the year to further our business strategy, notably our initiative to become a federal credit union. Marketing costs increased by $2.0 million in 2017 as we expanded our use of digital media and communications to keep our members and the public informed and aware of our service offerings. Regulatory costs increased in 2017 largely due to our Credit Union Deposit Insurance Corporation (CUDIC) assessment. Our base CUDIC assessment rate was unchanged year over year; however, our strong deposit growth results in 2016 impacted the volume side of the annual CUDIC assessment calculation, which is based on prior year-end deposits.

Non-Interest Expenses

Year ended December 31 in thousands of dollars	2017	2016	Change from 2016 $	%
Salaries and benefits				
Salaries including variable pay and incentives	132,312	115,133	17,179	14.9
Employee benefits, other	28,774	25,377	3,397	13.4
	161,086	140,510	20,576	14.6
Premises and equipment				
Rent, maintenance, utilities, taxes	26,424	26,667	(243)	(0.9)
Depreciation	5,135	5,561	(426)	(7.7)
	31,559	32,228	(669)	(2.1)
Member services administration				
Banking services	25,720	26,315	(595)	(2.3)
Loan processing	5,279	4,204	1,075	25.6
Investments and life insurance	3,216	2,737	479	17.5
	34,215	33,256	959	2.9
Technology				
Hardware, software, data, supplies	15,717	13,000	2,717	20.9
Depreciation	17,812	9,802	8,010	81.7
	33,529	22,802	10,727	47.0
Regulatory	12,447	11,323	1,124	9.9
Professional services	12,008	9,130	2,878	31.5
Telephone, postage	1,418	1,427	(9)	(0.6)
Marketing	7,828	5,806	2,022	34.8
Community contributions	5,600	5,598	2	0.0
Travel, meals and entertainment	3,511	3,212	299	9.3
Bonding and other insurance	2,238	2,349	(111)	(4.7)
Recruitment, training, conferences, dues	3,212	2,187	1,025	46.9
Other	781	5,539	(4,759)	(85.9)
	309,432	275,367	34,064	12.4

	2017	2016	Change from 2016 Basis points increase/(decrease)
Operating efficiency ratio	76.10%	76.71%	(61)

Capital Expenditures

Capital spending in 2017 was $13.7 million, 34% lower than the amount spent in 2016. The majority of our 2017 spending was attributed to technology investments in both hardware and software to maintain our infrastructure and expand digital services for our members. By contrast, 2016 spending was focused on leasehold improvements, furniture and equipment related to our new head office location, two new branches opened in Kelowna and Courtenay, and the move of our Central City branch to a new flagship location in our head office. A shift in recent years toward the use of cloud-based services to operate technology systems is also having an impact on capital spending. The emergence of cloud services has allowed us to shift some of our capital spending on local platforms to operating costs for cloud service platforms.

Year ended December 31 in thousands of dollars	2017	2016
Leasehold improvements	124	10,090
Computer equipment	5,587	3,480
Software	6,741	4,544
Furniture and equipment	1,231	2,702
Total	13,683	20,816

We expect our capital expenditures in 2018 to be higher compared to 2017. Spending in 2018 will focus on further enriching the digital service experience for our members. As well, we will be investing in automated processes for activities such as loan origination and approval, to increase simplicity and reduce turnaround times for our members. We will also be making necessary investments to maintain our core technology systems, and to refresh and update many of our existing branch locations.

Loan Portfolio

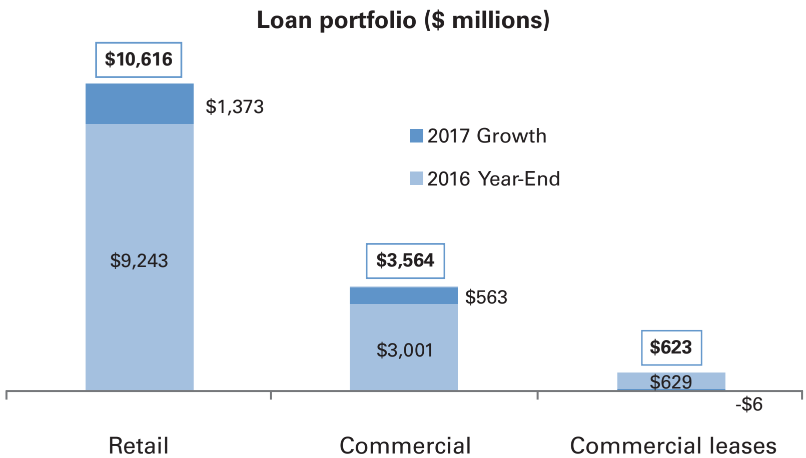
Total loans, including leases, increased by over $1.9 billion, or 15.0%, in 2017, representing our largest single-year loan growth result on record. Loan growth, attributed to the strength of the economy and the continuing robustness of the B.C. housing market, was stronger than planned for the year and almost 50% higher than in 2016. Retail mortgages and commercial construction mortgages experienced the strongest growth during the year. Growth related to commercial term financing and commercial leasing was more subdued in 2017.

Loan portfolio

As at December 31	2017				2016			
	Number	Total in millions of dollars[1]	Mix %	Average in thousands of dollars	Number	Total in millions of dollars[1]	Mix %	Average in thousands of dollars
Retail								
Mortgages								
Conventional	28,847	5,358	36.2	186	27,084	4,210	32.7	155
Revenue	4,285	1,460	9.9	341	3,895	1,224	9.5	314
Progressive	48	11	0.1	229	70	18	0.1	257
Insured	6,919	1,060	7.2	153	7,417	1,337	10.4	180
High-ratio	4,546	1,376	9.3	303	4,532	1,221	9.5	269
Mortgage-secured lines of credit	19,916	1,036	7.0	52	18,600	957	7.4	51
Subtotal mortgages	64,561	10,301	69.7	160	61,598	8,967	69.6	146
Other								
Other lines of credit	143,374	149	1.0	1	133,939	159	1.2	1
Personal loans and leases	11,306	166	1.1	15	11,724	117	0.9	10
Subtotal other	154,680	315	2.1	2	145,663	276	2.1	2
Subtotal retail	219,241	10,616	71.8	48	207,261	9,243	71.7	45

Commercial								
Commercial loans	15,846	3,564	24.0	225	16,052	3,001	23.4	187
Commercial leases	6,421	623	4.2	97	5,941	629	4.9	106
Subtotal commercial	22,267	4,187	28.2	188	21,993	3,630	28.3	165
Subtotal individuals and commercial	241,508	14,803	100.0	61	229,254	12,873	100.0	56
Accrued interest	–	21	–	–	–	18	–	–
Total loan portfolio	241,508	14,824	100.0	61	229,254	12,891	100.0	56

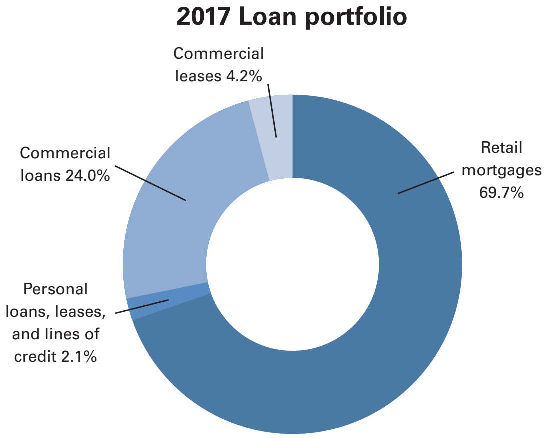
1 Before allowance for credit losses

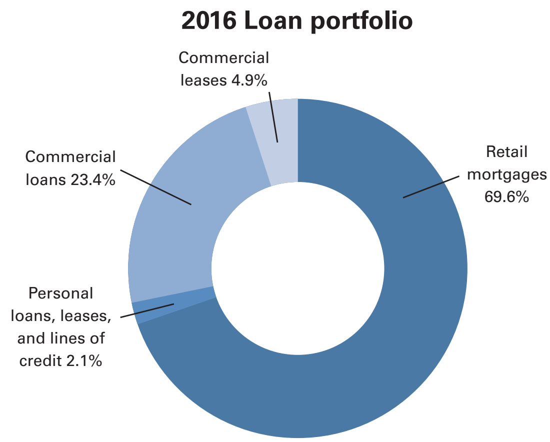


Our retail mortgage portfolio grew by almost $1.4 billion, 14.9%, in 2017 due to a combination of strong market demand, sales efforts, and our competitive Members Get It Mortgage offer. Mortgage growth was fairly balanced between variable and fixed-rate product through the first half of the year, but ended the year skewed towards fixed-rate product (80% of growth for the year) as members responded to prime rate increases in Q3.

Commercial mortgages, loans, and lines of credit grew by $563 million, or 18.8%, in 2017. Increased competition and compressed yields for commercial term mortgages suppressed the growth of our commercial term mortgage portfolio. The majority of our commercial loan portfolio growth in 2017 was generated in the development financing market, where both market demand and yields remained strong. As a result, in contrast to our retail portfolio, growth of our commercial loan portfolio was skewed towards variable rate product. Overall, as a percentage of our total loan portfolio, commercial loans increased from 23.4% to 24.0%.

Our total leasing division portfolio grew by $52 million, or 7.4%, in 2017. The leasing division auto financing portfolio (captured in our retail personal loans and leases category) grew by $58 million to $131 million, driven both externally through our dealer relationships and internally through our own members. This represents 81% growth in our leasing division auto financing portfolio, which started the year at $72 million. Our commercial equipment leasing portfolio finished the year at $623 million, a decrease of $6 million during the year. Application volumes for equipment leases were down 5% year over year, our application conversion ratio also decreased due to strong competition. As a percentage of our total loan portfolio, commercial leasing assets declined slightly in 2017, from 4.9% to 4.2%.





Deposits, Borrowing, and Liquidity

Deposits and Borrowing

Our deposit portfolio growth in 2017 was very strong at $1.4 billion or 10.8%. However, deposit growth generated by our core retail and commercial members during the year, at 7.2%, lagged behind the overall deposit growth rate. To achieve our total deposit growth result, and to support the funding of our exceptional loan growth during the year, we expanded the use of our established external deposit agent network and institutional depositor relationships. Deposits from these sources grew at 32.3% and 14.0%, respectively, in 2017:

Deposits by Source

As at December 31 in millions of dollars	2017	2016	Change from 2016 $	 %
Core retail and commercial members	10,680	9,962	719	7.2%
External deposit agents	1,938	1,465	473	32.3%
Institutional depositors	1,748	1,534	214	14.0%
Total	**14,366**	**12,961**	**1,406**	**10.8%**

Differences in the growth results across our deposit channels during the year resulted in a shift in our deposit portfolio towards non-core deposits. At the end of 2017, core retail and commercial member deposits accounted for 74.3% of our total deposits, down from 76.9% at the end of 2016.

Deposits by Source

As at December 31 in millions of dollars	2017	2016
Core retail and commercial members	74.3%	76.9%
External deposit agents	13.5%	11.3%
Institutional depositors	12.2%	11.8%
Total	**100.0%**	**100.0%**

Total deposit growth of $1.4 billion lagged our exceptional asset growth of almost $2.1 billion in 2017. The funding gap was accommodated through an increased use of borrowings. Total secured and unsecured borrowings grew $568 million or 65.4% in 2017, to $1.4 billion. At the end of 2017, total borrowings as a percentage of total liabilities increased to 9.0%, from 6.2% at the end of 2016.

Liabilities

Year ended December 31 in thousands of dollars	2017	2016	Change from 2016 $	%
Liabilities				
Deposits	14,366,432	12,960,818	1,405,614	10.8%
Borrowings	1,437,485	869,138	568,347	65.4%
Other liabilities	132,743	96,085	36,658	38.2%
Total liabilities	**15,936,660**	**13,926,041**	**2,010,619**	**14.4%**

Liabilities

Year ended December 31 As a percentage of total liabilities	2017	2016
Deposits	90.2%	93.1%
Borrowings	9.0%	6.2%
Other liabilities	0.8%	0.7%
Total	**100.0%**	**100.0%**

The increase in borrowings in 2017 were accommodated through a mix of term facility and secured borrowings, as well as through the issuance of short-term commercial papers.

Borrowings

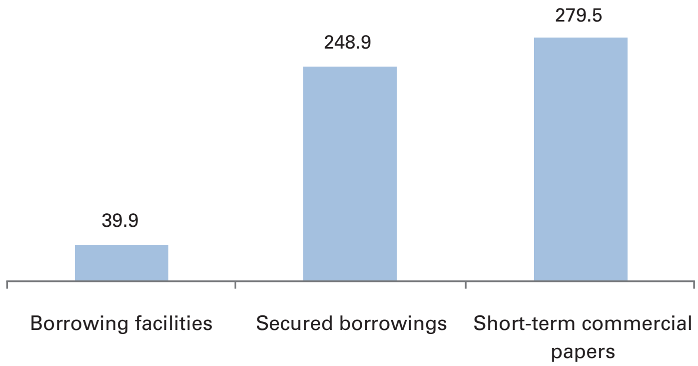
Year ended December 31 in thousands of dollars	2017	2016	Change from 2016 $
Borrowing facilities	39,937	–	39,937
Secured borrowings	1,118,025	869,138	248,887
Short–term commercial papers	279,523	–	279,523
	1,437,485	**869,138**	**568,347**

Maintaining healthy borrowing facilities and options is an essential element for managing short-term funding needs and for realizing on longer-term growth opportunities. The borrowing programs and facilities we currently maintain include:

- Lines of credit and short-term borrowing facilities with Central 1 other financial institutions. Borrowings through these facilities increased by $40 million in 2017.
- The National Housing Act Mortgage-Backed Securities (NHA MBS) and Canada Mortgage Bond (CMB) programs, which allow us to obtain low-cost funding through a process of securitizing existing mortgages. The long-term nature of CMB program funding is especially attractive in periods of exceptionally low interest rates, as was the case in 2017. In 2017, our borrowing through these programs increased by $249 million.
- Short-term commercial paper based on our DBRS short-term issuer rating. Our short-term issuer rating of R-1 (low) was originally obtained in 2016 and was reconfirmed in 2017. Under this rating, in 2017 we issued $280 million in short-term notes, reflecting a favourable market response to our offer.

To further diversify our funding options, in January 2018 we obtained a DBRS long-term issuer rating of BBB (high).

2017 Borrowing growth ($ millions)



Liquidity

Liquidity is an important measure related to the ability to settle cash flow obligations in a timely and cost-effective manner. The total liquidity ratio used by the Financial Institutions Commission of British Columbia (FICOM) measures total cash and liquid investments as a percentage of total deposits. In 2017, while our total deposits grew by $1.4 billion or 10.8%, our liquid assets grew by $145 million or 7.7%. Liquid asset growth at a slower rate than total deposit growth in 2017 is attributed to exceptionally strong loan growth, which outpaced our deposit growth, combined with efforts to manage the use of higher-cost funding through borrowings. As a result, our year-end total liquidity ratio decreased to 14.1% in 2017, from 14.5% in 2016. Despite this decrease, our total liquidity ratio remains well above FICOM's minimum threshold requirement of 8.0%.

Looking forward to 2018, several factors are expected to support the strengthening of our liquidity position. These include moderation of housing market activity, a more selective approach to mortgage growth driven by regulatory changes, and increased management focus on deposit growth opportunities. Additionally, our DBRS long-term issuer rating of BBB (high), obtained in January 2018, creates an additional borrowing option that can be used to support long-term liquidity needs.

As we continue to work towards federal credit union status, we also monitor liquidity metrics used by the Office of the Superintendent of Financial Institutions (OSFI), namely the Liquidity Coverage Ratio (LCR) and the Net Cumulative Cash Flow (NCCF) metric. OSFI requirements related to these liquidity metrics, along with applicable specific limits, will be identified in our policies upon continuance as a federal credit union.

Capital Management

Sustainable business growth and expansion of our helpful products and services depend on our ability to maintain a healthy capital ratio. As we have limited access to capital markets to raise equity capital, retained earnings growth remains our primary source of capital. Retained earnings growth is generated through profitable business operations, underscoring the importance of our pricing decisions and our efforts to manage expenses prudently to ensure we earn sufficient returns.

Regulatory Capital Requirements

Regulatory capital requirements set by the Financial Institutions Commission of British Columbia (FICOM) are based on the ratio of capital to risk-weighted assets. To maintain a stable capital ratio, increases in risk-weighted assets, whether through overall portfolio growth or through a shift towards higher-risk assets, requires additional capital. FICOM has set a supervisory minimum capital ratio for B.C. credit unions of 10%. Credit unions falling below this level are required to immediately improve their position to prevent supervisory intervention.

The regulatory capital formula identifies two types of capital – Tier 1 and Tier 2. FICOM requires that Tier 1 capital form at least 50% of the capital base. Tier 1 capital is comprised of retained earnings, voting shares, qualifying investment shares, and contributed surplus (net of deferred income tax assets, intangible assets, and goodwill). Tier 2 capital includes subordinated notes and other investment shares. It also includes 50% of our portion of system retained earnings, which includes Central 1 Credit Union (Central 1), CUDIC, and Stabilization Central Credit Union (Stab Central).

Assets in the regulatory capital formula are risk-weighted based on FICOM risk-weighting categories, which range from 0% to 150%. For example, conventional uninsured residential mortgages, the largest portion of our assets, are weighted at 35%, while commercial loans and leases, the second-largest portion, are weighted at 100%. Concentration risk factors, based on diversification within the portfolio, may also be applied to determine the risk-weighted asset amount.

The overall risk weighting of our asset portfolio for 2017 is 47.3%, up slightly from 46.5% in 2016. The change reflects the year-over-year increase in higher risk-weighted commercial loan and leasing assets.

2017 Impacts on Capital Ratio

On December 31, 2017, our total capital ratio, including Tier 1 and Tier 2 capital, was 14.7%, down from 15.6% at the end of 2016. The 2017 decrease reflects a higher growth rate for risk-weighted assets, at 15.8%, compared to our total regulatory capital growth at 9.2%. Growth of assets with a positive risk weighting, which we experienced in 2017, has an immediate impact on the capital ratio denominator; however, the income generated by those assets will generally occur over time, accumulating in retained earnings and contributing to capital growth in future periods.

Significant factors impacting our 2017 capital ratio:

- Risk-weighted asset growth of 15.8% was driven by strong overall asset growth of 13.9%, combined with an increase in our risk-weighted asset profile. During the year, our risk-weighted assets as a percentage of total assets increased from 46.5% to 47.3%. This increase reflects our increase in higher risk-weighted commercial loans and leases within our overall asset mix, and our decrease in cash and investments as a percentage of total assets during the year.
- Our total capital growth of $99.7 million in 2017, or 9.2%, was generated primarily by our increase in retained earnings from profitable operations, which contributed $74.6 million. Our portion of system equity (50% inclusion rate) added $21.6 million to our capital base in 2017, and a reduction in capital deductions year over year, related to goodwill and other intangible assets, had a $4.2 million favourable impact.

Tier 1 and 2 Capital

As at December 31

in thousands of dollars	2017	2016
Tier 1 capital		
Class A shares	2,581	2,524
Class B shares	28,851	30,444
Retained earnings	1,084,983	1,010,375
Deferred income taxes[1]	6,549	5,693
	1,122,964	1,049,036
Less: Capital deductions	(65,976)	(70,135)
	1,056,988	978,901
Tier 2 capital		
Portion of equity in Central 1, CUDIC, and Stab Central[2]	126,807	105,153
Total capital	1,183,795	1,084,054

[1] Statutory inclusion of only credit union deferred income taxes

[2] Portion of system related equity multiplied by 50%

Risk-Weighted Assets

As at December 31

in thousands of dollars	2017	2016		2017	2016
	Balance sheet amount	Balance sheet amount	BIS risk-weight (%)	Risk-weighted balance	Risk-weighted balance
Cash resources	1,656,527	1,426,134	–	–	–
Commercial paper	434,483	506,084	0-150	95,917	158,092
Residential mortgages	6,965,792	5,594,686	35	2,438,054	1,958,165
Insured mortgages	1,905,917	2,045,777	–	–	–
High-ratio mortgages 75 to 80% LTV	1,373,258	1,252,675	75	1,029,943	939,506
High-ratio mortgages > 80% LTV	5,192	1,083	75	3,894	812
Personal loans	183,871	204,075	75	128,682	141,411
Commercial loans and leasing	4,315,419	3,735,550	100	4,169,640	3,612,961
Other assets and investments	208,050	203,154	0-100	144,247	123,419
Off-balance-sheet exposure			0-100	46,026	21,813
	17,048,510	14,969,218	–	8,056,404	6,956,179
Risk-weighted assets as a percentage of total assets in per cent				47.3%	46.5%
Ratio of capital to risk-weighted assets					
Primary capital to risk-weighted assets				13.12	14.07
Secondary capital to risk-weighted assets				1.57	1.51
Total capital ratio				14.69	15.58
Total collective allowance for credit losses				32,275	30,498
As a percentage of risk–weighted assets				0.40%	0.44%

Maintaining a Sustainable Level of Regulatory Capital

In addition to the supervisory minimum capital ratio, FICOM requires that we establish an internal capital target above 10%. The internal target provides a trigger to allow the Board and management time to resolve unexpected capital impacts before the supervisory minimum level is reached. Further to this requirement, we annually complete an Internal Capital Adequacy Assessment Process (ICAAP) to assess our level of capital in relation to our risk appetite, risk profile, and external conditions. Based on this, we have set our minimum internal capital target at 14.25%.

As we work towards continuing as a federal credit union, we are aware that this change will require us to meet the regulatory capital adequacy requirements set by the Office of the Superintendent of Financial Institutions (OSFI). The move to OSFI regulation will change the risk weightings assigned to the different assets we hold, will change how we calculate our regulatory capital, and will require additional capital related to an operational risk assessment. In 2017 we created processes to measure, track, and report our regulatory capital ratios based on OSFI requirements.

As an additional tool for raising and maintaining sufficient capital levels, in January 2018 we obtained a DBRS long-term issuer rating of BBB (high). This rating provides us with the ability to access capital markets to generate new sources of capital funding if required.

Monitoring Capital Adequacy Risk

Our Internal Capital Adequacy Assessment Process (ICAAP) is jointly led by our Finance and Group Risk Management teams. The ICAAP provides a framework for determining the amount of capital that we require to manage unexpected losses arising from adverse economic and operational conditions. Modelling and stress testing, applied to near-term and longer-term planning, forecasting, and strategic objectives, is a key component of the ICAAP.

Our ICAAP includes the following elements:

- Identification and assessment of material risks and of risk mitigants
- Internal calculation of required capital levels based on the financial plan for the upcoming fiscal year and on current and prospective risk profiles
- Assessment of internal capital targets for reasonableness relative to internal and regulatory capital requirements
- Projection of capital levels forward over multiple years and assessment against regulatory and internal capital requirements
- Stress testing, which assesses the potential impact of severe but plausible events, such as severe economic recession, liquidity and interest rate shocks, earthquakes, and cyberattacks

Application of the ICAAP in 2017 confirms that our capital levels are healthy and sufficient for achieving our strategic plans and for successfully navigating through all stress scenarios considered.

Risk Management

To achieve our objectives and goals, we understand that we must selectively and prudently take and manage risks within our established risk appetite and tolerances, and that a strong risk culture and approach to managing risk is fundamental to our success. Our Enterprise Risk Management Framework (ERMF) defines our risk management methodology to ensure we effectively identify, assess, measure, control, monitor, and report risks within our approved risk appetite. Consistent application of the ERMF ensures ongoing and continuous reinforcement of an appropriate risk culture across the enterprise.

Risk Culture

Our risk culture embodies the tone at the top, which is set by the Board of Directors and the Executive Committee (EXCO), and it informs, and is informed by, our mission, corporate values, professional standards, and conduct. The governing objectives developed by the Board and EXCO describe the attitudes and behaviours that we seek to foster among our employees in building a culture where all employees understand the importance of managing risk and the role they play. Our goal is to create a risk culture that promotes accountability, learning from past experiences, and encourages open communication and transparency on all aspects of risk taking.

Risk Appetite

Our risk appetite is the aggregate level and types of risk that we are willing to accept, or avoid, in order to achieve our business objectives.

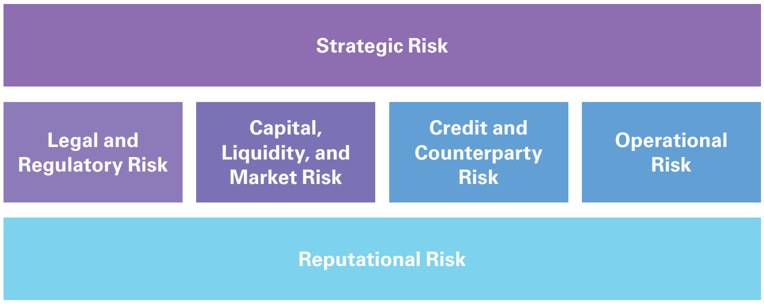
As we endeavour to improve our members' financial well-being through Simple financial help, we consider the risks associated with the strategies available to achieve this goal, our capacity to take such risks, and our appetite for such risks. Risk appetite considerations are an integral part of management decision-making, guided by Board oversight and approval of management actions. This includes considering risk appetite in short- and long-term strategic planning, in budget planning, and in assessing new products, services, activities, and markets.

Ultimately, our risk appetite is driven by:

- Coast Capital's strategy
- Coast Capital's risk principles
- Our risk capacity and constraints

Risk Inventory

We define risk as the possibility that an event will occur and adversely affect the achievement of our objectives. The ERMF defines and categorizes risks as outlined below:



Risk Principles

We believe in, and support the need for, a strong risk culture rooted in the following principles:

1. **We all understand that we take risk every day.** As part of our strategy to grow our business, we recognize the need to take acceptable risks, and manage the level of exposure it brings us, while also protecting our members' financial well-being.
2. **We are all responsible for managing the risk that we take on in a prudent and balanced way.** Certain risks are clearly owned, understood, and actively managed by management, with an understanding that all employees, individually and collectively, have the responsibility of managing the day-to-day risks of their job.
3. **We integrate managing risk into everything we do.** We integrate risk management disciplines and activities into our daily routines, decision-making, and strategy in a systematic, structured, and timely manner (as appropriate). We also understand that responsibility for managing risk spans all areas, including relationships with third parties.
4. **We have a culture that supports transparent and effective communication.** We recognize that mistakes happen, and that we need to recover quickly and gracefully when they occur. We support a culture that ensures that matters relating to risk are communicated and escalated in a timely, accurate, and forthright manner. It is important to understand how mistakes happen so that we can work together to quickly fix them and mitigate the risk going forward.
5. **We support the independent oversight provided by the risk management division.** While acknowledging that the business "owns the risk", we also understand the need for independent and objective review of risk policies, monitoring, and reporting.

Risk Governance and Management

We employ a risk management structure that emphasizes and balances strong central oversight and control of risk with clear accountability for – and ownership of – risk within each business line and corporate function.

Our Risk Principles emphasize that managing risks is a shared responsibility and that everyone plays a role in effective management of risks within the desired risk appetite, as outlined below:

Board of Directors

- The Board of Directors approves the risk appetite and provides risk oversight through its established committees
- The Risk Review Committee (RRC) is responsible for overseeing our risk profile and performance against the defined risk appetite. The RRC approves the ERMF and related frameworks and policies to manage the risk to which we are exposed.

Executive Committee

- Establishes tone at the top, provides strategic direction, manages strategic risk, and ensures our overall risk profile is aligned with our strategy, objectives, and goals
- Responsible for developing, executing, and managing strategies for their business areas, and ensuring such strategies are aligned with our risk appetite

Risk Committees

- The Credit Risk Committee (CRC) provides cross-functional oversight of key credit risks and controls in alignment with the risk appetite of Coast Capital Savings and is aligned with the risk governance, as a second line of defence, and risk management principles within the Credit and Counterparty Risk Management framework
- The Operational Risk Committee (ORC) is a management committee whose role is to oversee the effective management of operational risk across Coast Capital Savings and its related subsidiaries

First Line of Defence	Second Line of Defence	Third Line of Defence
Business Segment and Corporate Line Accountabilities	**Governance, Risk, and Oversight Function Accountabilities**	**Internal Audit Accountabilities**
IDENTIFY AND CONTROL	**SET STANDARDS, ASSESS, AND CHALLENGE**	**INDEPENDENT ASSURANCE**
• Identify and assess the risk within the respective business unit and assess the impact of risks to the respective business units • Establish appropriate mitigating controls • Oversee and report on the business line's risk profile and supporting operations within the approved risk appetite • Ensure timely and accurate escalation of material issues • Deliver training, tools and advice to support its accountabilities	• Establish and communicate enterprise governance, risk and control strategies, policies, and practices • Monitor and report on compliance with risk appetite and policies • Provide effective, objective assessment of risk management practices, processes, controls, and assessments prepared by the First Line of Defence • Review and contribute to the monitoring and reporting of our risk profile • Provide training, tools, and advice to support the First and Second Lines in carrying out their accountabilities	• Verify independently that our ERMF is appropriately designed and operating effectively • Validate the effectiveness of the First and Second Lines in fulfilling their mandates and managing risk

Risk Identification and Assessment

Risk identification and assessment is focused on recognizing and understanding existing risks, risks that may arise from new or evolving business initiatives, and risks that are emerging as a result of the changing business, economic, and competitive environment.

Our objective is to establish and maintain an integrated risk identification and assessment process that:

- Considers how risk types intersect
- Supports the identification and assessment of inherent risk
- Supports the identification and assessment of emerging risk
- Identifies existing controls and evaluates the effectiveness of those controls
- Assesses residual risk and determines the appropriate risk response and mitigation strategies
- Assesses the effectiveness of the mitigation strategies

Risk Measurement

The ability to quantify risk is a key component of our risk management process. Our risk measurement processes align with regulatory requirements such as adequacy of capital and liquidity levels, stress testing, and maximum credit exposure guidelines established by regulators. We have processes in place to measure and quantify risks to provide accurate and timely measurements of the risks that we assume.

Risk Information Specific to Our Financial Reporting
(Information below is an integral part of the audited financial statements)

Credit and Counterparty Risk
Credit and counterparty risk is the risk of loss emanating from a borrower or 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 borrower, counterparty guarantor, or the assets (collateral) supporting the credit exposure. We control these risks using risk rating limits that include portfolio, industry, and single name caps. We then regularly monitor and report these caps to manage any potential issues. Our system for controlling credit risk is founded upon strict adherence to clearly defined credit policies and approval procedures. We review lending practices and activities on a regular basis to ensure adherence to policy.

Maximum Exposure to Credit Risk
The table below presents the maximum exposure to credit risk of financial instruments included both on and off our statement of financial position, before taking into account collateral held or other credit enhancements. For statement of financial position assets, the credit risk exposure equals their carrying amount. For financial guarantees granted, the exposure is the maximum amount that we would have to pay if counterparties called upon the guarantees. For loan commitments and other credit-related commitments that are irrevocable over the life of the respective facilities, the maximum exposure is the full amount of the committed facilities.

Maximum Exposure to Credit Risk

As at December 31, 2017

in thousands of dollars	Banking	Derivatives
On balance sheet		
Cash held at Central 1	96,507	
Investments held at Central 1	1,545,019	
Shares in Central 1	69,330	
Other investments	382,829	
Loans	14,788,882	
Derivative instruments	–	(48)
Accounts receivable	7,041	
	16,889,608	(48)
Off balance sheet		
Letters of credit	70,715	
Commitments to extend credit	4,455,174	
	4,525,889	–
Maximum exposure to credit risk	21,415,498	(48)

Concentration Risk
Concentration risk arises through larger value exposures where a number of borrowers are engaged in similar economic activities or are located in the same geographic region. Residential mortgages represent our largest concentration of loan assets at 63% of our total loan exposure. We carry out the majority of our lending activities in the Metro Vancouver, Fraser Valley, and southern Vancouver Island regions of B.C. New branch openings at the end of 2016 extended our activities to include the mid-Island and Interior of B.C., specifically Courtenay and Kelowna. Residential real estate prices in our region of operation have experienced significant price increases in recent years. Understanding that prices often move and fluctuate in cyclical patterns, we monitor our residential real estate exposure on an ongoing basis, including delinquency trending and modelling of price change impacts on collateral value. This monitoring, combined with sound underwriting practices, ensures our residential real estate risk exposure is maintained within an acceptable level.

As at December 31, 2017 in thousands of dollars	Outstanding	Undrawn commitments	Letters of credit	Derivatives	Total exposure
Residential mortgages	10,300,529	1,855,205			12,155,734
Personal loans	314,633	954,124			1,268,757
Commercial					
Construction	1,248,291	1,008,311	54,603		2,311,205
Food services and accommodation	97,154	31,602	470		129,226
Agriculture	48,793	2,550	29		51,372
Finance and Insurance	7,079	3,949	54		11,082
Manufacturing	116,997	26,214	20		143,231
Professional	21,715	25,678	68		47,461
Real estate	1,679,388	347,551	3,704		2,030,643
Retail and wholesale trade	137,149	40,077	1,780		179,006
Transportation	417,303	14,905	275		432,483
Other	413,553	145,008	9,712		568,273
	14,802,584	4,455,174	70,715	–	19,328,473

Market Risk

Market risk relates to interest rate and foreign exchange market fluctuations that can impact our profitability, capital and ability to achieve business objectives. The majority of our revenue is generated from the spread between the interest we earn on loans and the interest we pay on deposits. The mismatch between the timing and volume of loan and deposit maturities creates interest rate risk. If the maturity mismatch between loans and deposits results in deposit interest costs increasing at a faster pace than the interest earned from loans, our spreads will decline. We are additionally impacted by volume mismatches between variable rate loans and deposits. As our current statement of financial position profile has a larger proportion of variable rate assets versus variable rate liabilities, our income is compressed as interest rates decline.

Our treasury team use strategies to manage the spread between deposit and loan rates for different maturities, while making sure to stay within risk appetite policy limits. The treasury team also provides recommendations to our Asset Liability Committee (ALCO). ALCO meets regularly to review our interest rate risk profile in conjunction with the current economic environment and sets direction for management to develop and implement.

Asset and Liability Maturities

As at December 31 in thousands of dollars	2017			2016		
	Assets	Liabilities and equity	Differential	Assets	Liabilities and equity	Differential
Variable rate	6,366,382	4,701,613	1,664,769	5,650,701	4,762,583	888,118
Interest sensitive						
Maturing within 1 year	2,013,574	6,192,232	(4,178,658)	1,679,700	5,123,672	(3,443,972)
Maturing between						
1–2 years 2019	1,303,739	1,387,400	(83,661)	1,581,073	1,025,622	555,451
2–3 years 2020	1,698,175	1,049,907	648,268	1,059,697	560,113	499,584
3–4 years 2021	2,513,359	323,094	2,190,265	1,663,285	514,840	1,148,445
4+ years 2022+	2,826,295	450,625	2,375,670	3,005,856	340,253	2,665,603
Non–interest bearing items[1]	326,986	2,943,639	(2,616,653)	328,906	2,642,135	(2,313,229)
	17,048,510	17,048,510	–	14,969,218	14,969,218	–

1 Assets include cash, accrued interest receivable, premises and equipment and other items.
Liabilities and equity include accrued interest payable, retained earnings, Class B shares and other items.

Impact on Interest Income

We measure the impact of rate changes on our net interest income using modelling and assumptions applied to our year-end portfolio and expected portfolio changes looking forward 12 months. The impacts of a 1% rate increase and 1% rate decrease are significantly larger based on our 2017 analysis compared to our 2016 analysis. The main factors contributing to this result include significant year-over-year growth of both our assets and liabilities; changes to the mix of assets and liabilities in our portfolio in terms of interest rate sensitivity; changes in assumptions used to calculate the magnitude of rate change impacts on certain types of assets and liabilities held within our portfolio; and higher prevailing interest rates at the end of 2017, which broadens the range of impact of a 1% rate change on certain assets and liabilities held within our portfolio (notably with respect to the decrease in rates scenario).

	2017	2016
1% increase in rates	$ 26,632	$ 6,319
1% decrease in rates	$ (21,948)	$ (1,801)

Liquidity and Funding Risk

Liquidity and funding risk relates to the ability to satisfy cash flow obligations in a timely and cost-effective manner. The *Financial Institutions Act* (FIA) requires us to maintain a minimum of 8.0% of our total deposits and borrowings in a liquidity portfolio. As part of this regulation, we are also required to hold statutory liquidity with Central 1 equalling the greater of 6.0% of our total deposits and borrowings or 1.5% of the B.C. credit union system's assets. Central 1 deposits provide yields similar to those of Government of Canada treasury bills or bonds. In addition to our Central 1 liquidity portfolio, we hold other liquidity investments with a minimum credit rating of R-1 low (A-) or higher. Acceptable investments are identified in our liquidity and funding risk policy.

Our intention is to maintain a total liquidity portfolio at or above 10.0% of total deposits and borrowings. This level provides us with an operating cushion relative to the FIA minimum in the event of rapid asset growth or sudden deposit declines. Our Liquidity Contingency Management Plan includes ongoing monitoring to determine the health of our liquidity, as well as the actions needed, should we experience a liquidity event.

To improve our ability to respond to and manage liquidity and funding requirements, we maintain borrowing facilities with Central 1 and other financial institutions, and make use of the National Housing Act Mortgage-Backed Securities (NHA MBS) and Canada Mortgage Bond (CMB) programs. To expand and diversify our funding options, in 2016 we obtained a DBRS short-term issuer rating (R-1 (low)), and in January of 2018 we also obtained a DBRS long-term issuer rating (BBB (high)). These ratings demonstrate our sound financial position, providing assurance to our members and to capital market participants.

As we continue to work towards federal credit union status, we also monitor liquidity metrics used by the Office of the Superintendent of Financial Institutions (OSFI), namely the Liquidity Coverage Ratio (LCR) and the Net Cumulative Cash Flow (NCCF) metric. OSFI requirements related to these liquidity metrics, along with applicable specific limits, will be identified in our policies upon continuance as a federal credit union.

Internal Controls over Financial Reporting and Disclosures

Internal Controls over Financial Reporting (ICFR) are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. However, because of its inherent limitations, ICFR may not prevent or detect misstatements on a timely basis. We are always looking for best practices in financial reporting and corporate governance. To this end, similar to public companies, we have a process in place to evaluate the design and operating effectiveness of our ICFR. Through this evaluation process we strive to continually strengthen our system of internal controls over financial reporting.

Critical Accounting Estimates

This section describes areas in our financial statements where we have made judgments. Where possible, we indicate the impact on our estimate if our assumptions were changed. Our estimates are well-documented and appropriate.

Allowance for Credit Losses

We maintain an allowance for credit losses that we consider our best estimate of probable credit-related losses existing in our portfolio. The allowance has both specific and collective components.

Specific Allowance
Specific allowances reduce our loan asset value to realizable amounts for loans identified as impaired. We review all individual loans above a threshold that become delinquent, and we determine the realizable value of the loan by estimating future cash flows, which is often the value of the underlying security. We apply judgment on the realization period and on the valuation of the underlying security. Additionally, for significant loans, we may obtain third-party valuation of the collateral.

Collective allowance
Collective allowances provide for credit losses that we believe may exist but have not yet been specifically identified. Our collective allowance model incorporates a number of factors, applied to each loan portfolio type, such as:

- Size of the portfolio
- Probability of default
- Loss given default
- Estimated lag period between loss event and identification

Additionally, we consider current observable factors that influence losses in our portfolio. Deterioration in these factors, such as changes in unemployment rates and provincial GDP measures, will cause losses that we may not yet have detected in our model. We apply judgment in evaluating the severity of changes to these observable factors. While the performance of each of our portfolios drives the inputs to our model, we apply judgment when we have gaps in data or when results are counterintuitive. A uniform 10% increase in the probability of default across all portfolios causes the collective allowance to increase by approximately $3.0 million.

Financial Instruments Measured at Fair Value
We record all securities, derivatives, and certain loans at their fair value. In the case of a derivative liability, fair value represents our estimate of what we would receive, or pay, in a transaction between two willing parties. The best evidence of fair value is a quoted bid or ask price, as appropriate, in an active market.

Where bid and ask prices are unavailable, we use the closing price of the most recent transaction of that instrument. Where quoted prices are not available for a particular financial instrument, we estimate fair value using the quoted price of a financial instrument with similar characteristics and risk profile, or observable market–based inputs that drive internal or external valuation models.

Determining fair value for instruments that trade actively and have quoted market prices (Level 1) requires minimal subjectivity. We have to apply judgment to value other instruments. We value derivatives using readily available market information that can be input to internal models (Level 2). We validate the outputs by comparing our valuations with counterparties. When we use internal models without observable market information (Level 3), we use general assumptions such as internal pricing spreads over observable market inputs. All modelled valuations consider credit risk adjustments, as appropriate. We disclose these valuations in Note 26.

We record changes in fair value to the income statement unless we have elected a security to be available for sale or have designated a derivative as an effective cash flow hedge. On December 31, 2017, we carried $1.3 billion, or 7.4%, of our financial assets and $9.0 million of our financial liabilities (all derivative instruments) at fair value. Included in the financial assets is $14.3 million ($15.3 million as of December 31, 2016) of loans where we have made a fair value option in order to match valuations of hedged and hedging items.

Effective December 31, 2017, Central 1 announced that 24.9502% of Coast Capital's Class E shares would be redeemed at a value of $100 per share subsequent to year-end. These shares have been recorded at a fair value of $100 per share, with the gain of $10,082 (2016 – nil) being recorded in Other Comprehensive Income, net of tax of $2,083. All other investments in Class E shares are recorded at their cost of $0.01 per share, as the fair value cannot be reliably measured. There is no quoted market price for the shares, and the likelihood and timing of any future redemption of the shares cannot be determined.

Asset Impairment (Goodwill and Intangible Assets)
On December 31, 2017, total goodwill was $15.2 million, identifiable intangible assets with a definite life were $5.0 million, and software was $51.4 million. The combined total of these amounts increased in 2017 by $6.7 million due to software additions, and decreased by $14.8 million from amortization and by $0.6 million from disposals of software. Assessments were made in 2017 to accelerate the depreciation schedule for certain software assets. Goodwill represents the excess of

consideration exchanged for the acquisition of a subsidiary over the fair value of the net assets acquired. The majority of our goodwill balance at year-end resulted from our 2014 acquisition of the prime equipment and vehicle finance business of Travelers Financial Corporation.

At least annually, we are required to test these assets for impairment. These impairment tests consist of comparing the carrying value with the fair value of the reporting unit. We apply judgment in measuring fair value when estimating future cash flows expected to result from the use of the asset and its eventual disposition, and in determining the useful life of these intangible assets in order to determine annual amortization. We had no impairment of goodwill during the year.

Contingent Liabilities

In the ordinary course of our business, we are party to a number of legal proceedings. In accordance with accounting standards, we accrue amounts if, in our opinion, we believe that a future event will confirm existence of a liability at the date of the financial statements, and if we can reasonably estimate the amount of the loss.

At times, however, it is either not possible for us to determine the existence of a liability or to reasonably estimate the amount, until the case is closer to resolution. In such cases, we do not accrue any amounts until that time. If the reasonable estimate of loss involves a range within which a particular amount appears to be a better estimate, we will accrue that amount. If we have no better estimate within a range, we accrue the minimum amount in the range.

It is inherently difficult to predict the outcome of such matters. For this reason, we regularly assess the adequacy of our contingent liability accrual and make adjustments to incorporate new information as it becomes available. Based on current knowledge and consultation with legal counsel, we do not expect the outcome of any of these matters (individually or in aggregate) to have a material adverse effect on our consolidated financial position. However, the outcome of any such matters, individually or in aggregate, may be material to our operating results for a particular year.

Income Taxes

We use sound judgment when estimating income taxes and deferred income tax assets and liabilities. In addition to estimating our actual current tax exposure, we assess temporary differences that result from the different treatments of items for tax and accounting purposes, as well as any tax loss carry-forwards.

Depending on our ability to grow deposits, we have access to a B.C. credit union deduction that can reduce our effective tax rate. We previously also had access to a federal credit union deduction; this was fully phased out at the end of 2016.

When valuing our deferred income tax assets and liabilities, we estimate future reversing tax rates based on our forecast growth for deposits and income before taxes. If we estimate our future reversing rate to be 1% higher, our net deferred income tax assets will be impacted minimally. As of December 31, 2017, we had available deferred income tax assets of $20.3 million ($23.3 million in 2016) and deferred income tax liabilities of $17.2 million ($20.1 million in 2016). One driver of adjustments to future reversing rates is changes to enacted tax rates such as the announcement by the Province of B.C. to increase the general business tax rate by 1% effective January 1, 2018, and to decrease the small business tax rate by 0.5% effective April 1, 2017.

We have to assess whether realizing our deferred income tax assets prior to their expiration is more likely than not. If we believe we will have future taxable profits that will allow us to claim deductible temporary differences, we recognize the full deferred income tax assets. The factors we use to assess this likelihood include:

- Past experience of income and capital gains
- Forecast of future net income before taxes
- Available tax planning strategies that could be implemented to realize the deferred income tax assets
- The remaining expiration period of tax loss carry-forwards

We believe, based on all available evidence, that we will realize the remaining deferred income tax assets prior to their expiration.

Future Changes to Accounting Policies

The International Accounting Standards Board (IASB) has issued new standards and amendments to existing standards on financial instruments, revenue from contracts with customers, and leases that were not yet effective for the year ended December 31, 2017. These accounting changes will be applicable beginning January 1, 2018, at the earliest. Additional information on the new standards and amendments to existing standards can be found in Note 3 to the annual consolidated financial statements.

IFRS 9: Financial instruments

In July 2014, the IASB issued the final version of IFRS 9 – *Financial Instruments* (IFRS 9), which will replace IAS 39 – *Financial Instruments: Recognition and Measurement* (IAS 39). The final version of IFRS 9 is effective for annual periods beginning on or after January 1, 2018. Disclosures related to IFRS 9 will also be adopted on January 1, 2018. IFRS 9 addresses classification and measurement of financial instruments, impairment of financial assets, and general hedge accounting.

IFRS 9 does not require restatement of comparative period financial statements except in limited circumstances related to aspects of hedge accounting. Coast Capital does not plan to restate prior period comparative figures and will recognize an adjustment to opening retained earnings to reflect the application of the new requirements as at the date of transition.

The adoption of IFRS 9 will have a significant impact on our impairment processes and the resulting estimate of allowances for credit losses. We continue to refine our impairment processes and estimates in fiscal 2018; therefore, the actual impact on adoption may change and the final impact on our financial position, allowance for credit losses, and capital ratios cannot yet be determined with conclusiveness.

Project Status

The transition to IFRS 9 is a significant initiative, particularly in regards to the new impairment requirements. Key stakeholders and resources were identified early in the process to work on the various elements of the new standard. Furthermore, to address the new impairment requirements, an IFRS 9 working group, which includes joint leadership and representation from risk management and finance, and representation from other business function stakeholders, was set up when the project was initially launched to coordinate and execute the adoption of the new IFRS 9 impairment requirements in accordance with a robust project plan, which includes three main project phases.

Phase 1 – Planning and Scoping

This phase was completed in 2016. The objective of Phase 1 was to complete an assessment of the requirements in IFRS 9 and to evaluate the overall effort required to transition to IFRS 9. Phase 1 allowed the project resources and IFRS 9 working group to build knowledge with respect to IFRS 9 requirements and to complete diagnostic analyses to identify key differences between current practices and IFRS 9. Furthermore, a fuller understanding of the requirements allowed us to better define roles, responsibilities, project milestones, and deliverables.

Phase 2 – Analysis and Design

This phase started in 2016 and continued throughout 2017. The objective of Phase 2 involves performing analyses and developing methodologies to meet the requirements of IFRS 9. While the new classification and measurement and hedge accounting requirements may have important implications, the key elements of Phase 2 pertain to the impairment requirements. The latter involves defining risk methodologies and accounting policies, confirming data sources and requirements, developing methodologies to establish risk parameters, defining functional requirements for calculating the estimated allowances for credit loss, and developing an estimation approach and platform. Phase 2 also includes reviewing and analyzing the IFRS 9 disclosure requirements.

Phase 3 – Implementation and Review

This phase started during the latter part of 2017, as a significant portion of the work was completed during the year. Phase 3 consists mainly of efforts to implement the estimation processes and platforms and to refine the methodologies throughout 2018. Other implications such as financial statement disclosures, internal controls over financial reporting, and incorporation into planning and forecasting activities will begin as the analyses are completed, in advance of fiscal 2018 financial reporting. We are on track to meet the transition timelines and the focus, going into 2018, will be on the development and validation of an estimation platform.

Impairment

IFRS 9 introduces a new expected credit loss (ECL) model, which must be applied to all financial assets classified at amortized cost or fair value through other comprehensive income, for calculating impairment losses. The most significant impact is expected to be on loans. The model results in the recognition of an allowance for credit losses on financial assets regardless of whether a loss event occurred; the magnitude of the estimated ECL is based on changes in credit risk since initial recognition. This difference in the scope of its application is one of the most significant differences between IAS 39 and IFRS 9, in that IAS 39 requires application of an incurred-loss impairment model; therefore, an allowance for credit losses is only required for losses that are incurred but not yet identified, while IFRS 9 requires entities to recognize an allowance for all future expected losses.

IFRS 9 requires recognition of:

- 12-month ECL from the date a financial asset is first recognized ("stage 1 loans" or "performing loans"), which is measured as the amount of ECL occurring in the next 12 months
- Lifetime ECL if the credit risk on that financial asset has increased significantly since initial recognition ("stage 2 loans" or "underperforming loans"), which is measured as the amount of ECL occurring over the remaining life of the asset. In assessing whether credit risk has increased significantly, Coast Capital compares the risk of a default as at the reporting date, with the risk of default as at the date of initial recognition.
- Lifetime expected credit losses for financial assets that are assessed as credit impaired ("stage 3 loans", "impaired loans", or "non-performing loans")

ECLs will be a function of the probability of default (PD), loss given default (LGD), and exposure at default (EAD) discounted to the reporting date, measured as the probability-weighted ECL over 12 months or the remaining expected life of the financial instrument. The methodology and inputs will consider reasonable and supportable information about past events, current conditions, and forecasts of future events and economic conditions that impact the credit risk assessment. Examples of relevant macroeconomic factors include unemployment rates, housing price index, and interest rates, which is consistent with information used for other purposes, including forecasting and planning. Probability-weighted multiple scenarios will be considered when assessing changes in credit risk since initial recognition and measuring ECLs.

In regards to the credit risk assessment process, we will be using a combination of account- and/or borrower-specific attributes and relevant forward-looking variables to evaluate the changes in credit risk since initial recognition. IFRS 9 also requires the application of a rebuttable presumption that credit risk has increased significantly since initial recognition when contractual payments are more than 30 days past due. We do not expect to rebut this presumption for assessing changes in credit risk for its loans. Financial assets will be assessed as credit impaired when they are 90 days or more past due.

Under IFRS 9, ECLs will be recognized in profit or loss before a loss event has occurred, which will likely result in earlier recognition of credit losses, compared to the current model. Also, given that ECL will consider multiple scenarios and forecasts, and that assets will be moving between stages as the assessed risk of default improves and deteriorates over their lifetimes, allowances are expected to be more sensitive and volatile compared to the current IAS 39 model. Coast Capital's specific allowances under IAS 39 will be replaced by the ECL for stage 3 loans and the collective allowances will be replaced by the ECL for stage 1 and stage 2 loans.

Classification and Measurement

IFRS 9 requires all financial assets to be classified in three categories (amortized cost, fair value through profit or loss (FVTPL), or fair value through other comprehensive income (FVOCI)), based on the contractual cash flow characteristics of the assets and the business model under which the assets are managed. We have substantially completed the assessment of our business models and the contractual cash flow characteristics of the financial assets in the scope of IFRS 9, and it is expected that certain assets may be reclassified upon transition to IFRS 9 on January 1, 2018.

IFRS 9 provides an irrevocable designation that can be made at initial recognition to measure a financial asset at fair value through profit or loss if doing so eliminates or significantly reduces an accounting mismatch. Furthermore, an irrevocable designation can be made at initial recognition to classify certain equity securities at fair value through other comprehensive income, but no subsequent recycling of gains and losses will be recognized in the Consolidated Statement of Income.

The classification and measurement of financial liabilities remain essentially unchanged from the current IAS 39 requirements, except for the measurement of financial liabilities elected to be measured at fair value. We have not made use of this election.

Hedge accounting

IFRS 9 introduces a new hedge accounting model that aims to provide a better link between an entity's risk management activities and the impact of hedging on the financial statements. Also, IFRS 9 is expected to allow for application of the hedge accounting requirements to a broader array of hedging relationships. Accounting requirements for macro hedging have been separated from IFRS 9; therefore, entities may choose to continue applying the current hedge accounting requirements under IAS 39 until the IASB finalizes its macro hedge accounting project. We have elected the accounting policy choice to continue applying the IAS 39 hedging requirements. However, the new hedge accounting disclosures will be adopted effective January 1, 2018.

IFRS 15: Revenue from Contracts with Customers

In May 2014, the IASB issued IFRS 15 – *Revenue from Contracts with Customers* (IFRS 15), which establishes a comprehensive framework for the recognition, measurement, and disclosure of revenues. IFRS 15 applies to all contracts with customers (except for contracts that are within the scope of the standards on leases and financial instruments). IFRS 15 is effective for annual periods beginning on or after January 1, 2018. On transition, entities may either restate prior periods retrospectively or recognize the cumulative effect of the transition in opening retained earnings with no comparison for prior years. We have substantially completed the assessment of the potential impacts of IFRS 15 and currently do not expect a significant impact from adopting the new standard. We dos not plan to restate prior period comparative figures and will recognize an adjustment to opening retained earnings to reflect the application of the new requirements as at the date of transition.

IFRS 16: Leases

In January 2016, the IASB issued IFRS 16 – *Leases* (IFRS 16), which sets out the principles for the recognition, measurement, presentation, and disclosure of leases for both parties to a lease contract. IFRS 16 replaces the previous leases standard, IAS 17 – *Leases* (IAS 17), and related interpretations. IFRS 16 requires most leases, including operating leases, to be recorded on the balance sheet as right-of-use assets, resulting in an increase in lease assets and corresponding lease liabilities. We are currently assessing the potential impact of the adoption of IFRS 16 and the recognition of lease assets and financial liabilities on its consolidated financial statements and regulatory capital ratios. IFRS 16 is effective for annual periods beginning on or after January 1, 2019.